

# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



19981023 022

## THESIS

### FOREIGN MILITARY SALES VERSUS DIRECT COMMERCIAL SALES

by

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September 1998

Thesis Advisor:

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<b>REPORT DOCUMENTATION PAGE</b>			<i>Form Approved</i> OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
<b>1. AGENCY USE ONLY</b>		<b>2. REPORT DATE</b> September 1998	<b>3. REPORT TYPE AND DATES COVERED</b> Master's Thesis	
<b>4. TITLE AND SUBTITLE : FOREIGN MILITARY SALES VERSUS DIRECT COMMERCIAL SALES</b>			<b>5. FUNDING NUMBERS</b>	
<b>6. AUTHOR(S)</b> Gultekin, Metin				
<b>7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)</b> Naval Postgraduate School Monterey, CA 93943-5000			<b>8. PERFORMING ORGANIZATION REPORT NUMBER</b>	
<b>9. SPONSORING / MONITORING AGENCY NAME(S) AND ADDRESS(ES)</b> N/A			<b>10. SPONSORING / MONITORING AGENCY REPORT NUMBER</b>	
<b>11. SUPPLEMENTARY NOTES</b> The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
<b>12a. DISTRIBUTION / AVAILABILITY STATEMENT</b> Approved for public release; distribution is unlimited.			<b>12b. DISTRIBUTION CODE</b>	
<b>13. ABSTRACT</b> <p>The transfer of arms from the U.S. to other countries under the Security Assistance Program is done in two basic ways: government-to-government Foreign Military Sales (FMS), and contractor-to-government Direct Commercial Sales (DCS). These methods help to increase standardization and interoperability between the U.S. and its Allies. This study examines the U.S. arms sales policies and procedures for FMS and DCS. It is aimed at identifying the advantages and weaknesses of these methods and to provide information to the Turkish Navy decision-makers for future arms procurements. The objective of this study is to improve the effectiveness and efficiency of the Turkish Navy in procuring weapon systems/services from U.S. sources.</p> <p>The research found demonstrates that the choice of either FMS or DCS is driven by the special circumstances of the Turkish Navy, rather than by substantive differences in the two systems. The final decision on procurement methods with the U.S. depends on the country and items to be purchase. This study examines the major trade-offs between the FMS and DCS systems, and recommends the factors which the Turkish Navy should take into account to minimize costs, maximize effectiveness, and maximize efficiency.</p>				
<b>14. SUBJECT TERMS</b> Foreign Military Sales, Direct Commercial Sales, Turkish Navy, Arms Sales, Security Assistance			<b>15. NUMBER OF PAGES</b> 104	
			<b>16. PRICE CODE</b>	
<b>17. SECURITY CLASSIFICATION OF REPORT</b> Unclassified	<b>18. SECURITY CLASSIFICATION OF THIS PAGE</b> Unclassified	<b>19. SECURITY CLASSIFICATION OF ABSTRACT</b> Unclassified	<b>20. LIMITATION OF ABSTRACT</b> UL	

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-  
Prescribed by ANSI Std. Z39-18)



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## FOREIGN MILITARY SALES VERSUS DIRECT COMMERCIAL SALES

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submitted in partial fulfillment of the  
requirements for the degree of

### MASTER OF SCIENCE IN MANAGEMENT

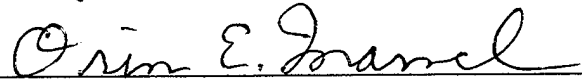
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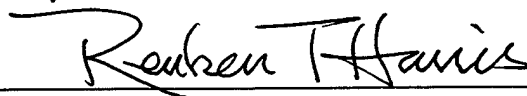
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## **ABSTRACT**

The transfer of arms from the U.S. to other countries under the Security Assistance Program is done in two basic ways: government-to-government Foreign Military Sales (FMS), and contractor-to-government Direct Commercial Sales (DCS). These methods help to increase standardization and interoperability between the U.S. and its Allies. This study examines the U.S. arms sales policies and procedures for FMS and DCS. It is aimed at identifying the advantages and weaknesses of these methods and to provide information to the Turkish Navy decision-makers for future arms procurements. The objective of this study is to improve the effectiveness and efficiency of the Turkish Navy in procuring weapon systems/services from U.S. sources.

The research found demonstrates that the choice of either FMS or DCS is driven by the special circumstances of the Turkish Navy, rather than by substantive differences in the two systems. The final decision on procurement methods with the U.S. depends on the country and items to be purchase. This study examines the major trade-offs between the FMS and DCS systems, and recommends the factors which the Turkish Navy should take into account to minimize costs, maximize effectiveness, and maximize efficiency.



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## **I. INTRODUCTION**

### **A. BACKGROUND**

The Turkish Armed Forces is becoming a leaner and meaner fighting force. However, due to budgetary constraints, efforts to modernize are limited only to pursuing those programs, which will truly increase combat capabilities and effectiveness. Therefore, the Turkish Navy has to plan ahead and buy prudently to build a fleet capable of meeting the requirements of the 21<sup>st</sup> Century.

Turkey's geographic position and coastline bring out the importance of its Navy that can provide protection of the country and NATO's Southern Flank. Although overall security has improved significantly in recent years, considerable dangers still remain in NATO's Southern Region.

The Turkish Navy continues to enhance its war-fighting capabilities through either direct procurement of new systems or modernization of existing equipment. These efforts involve acquisition of new systems, upgrading existing equipment, and the support of new equipment for the modernization of the force structure. The Turkish Navy plans to integrate smart acquisition programs to equip war-fighters with better fighting capabilities to achieve effectiveness and efficiency.

The Turkish Government intends to launch defense procurement programs to bolster its Army, Navy and Air Force capabilities with a total budget of US\$31 billions for defense contracts through 2005. According to the Turkish Government and industrial sources, this figure may reach as much as US\$150 billions by 2025. [Ref. 1:p. 8] The

scarcity of resources mandates practicing more effective and efficient ways of purchasing. To implement military transfers, the U.S. developed the concept of "Security Assistance." Security Assistance is an "umbrella" term for a group of programs in which the U.S. provides defense articles, military training, and other defense related services to allied and friendly nations.

Currently, the transfer of military weaponry from the U.S. to other countries under the Security Assistance Program is done in two basic ways: government-to-government Foreign Military Sales (FMS), and contractor-to-government Direct Commercial Sales (DCS). Both systems have been designed to achieve a common goal, which is the enhancement of mutual security objectives through providing U.S. military items and services to allied and friendly foreign governments. [Ref. 2:p. 648]

FMS is that portion of the U.S. Security Assistance Program authorized by the Arms Export Control Act (AECA) of 1976 and conducted on the basis of formal contracts or agreements between the United States Government (USG) and an authorized recipient government or international organization. FMS includes government-to-government sales of defense articles or services from Department of Defense (DoD) stocks or through purchase under DoD managed contracts, regardless of the source of financing. DCS is also authorized under the Arms Export Control Act (AECA) of 1976. A DCS licensed under the AECA is a sale made by an U.S. company directly to a foreign customer. Unlike the procedures employed for FMS, DCS transactions are not administered by DoD and do not involve a government-to-government agreement. Rather, the U.S. governmental "control" procedure is accomplished through licensing by the Office of Defense Trade Control (DTC) in the Department of State. [Ref. 3]

## **B. THESIS OBJECTIVES**

This research presents a comparison of Direct Commercial Sales (DCS) and Foreign Military Sales (FMS) for the acquisition of U.S. Defense Articles and Services. The objectives of the thesis are to describe and analyze the FMS and DCS methodologies and to identify their advantages and weaknesses. It is designed to allow Turkish Navy decision-makers to determine whether to use FMS or DCS for future defense upgrades.

## **C. SCOPE AND LIMITATION OF RESEARCH**

The scope of this thesis includes a historical and an in-depth review of FMS and DCS processes for the transfer of U.S. weapon systems and services to foreign customers. It evaluates the two processes and identifies their benefits and deficiencies for the Turkish Navy.

## **D. RESEARCH QUESTIONS**

### **1. Primary Research Question**

What are the advantages and the disadvantages of FMS and DCS for the acquisition of U.S. Defense articles and services to the Turkish Navy?

### **2. Subsidiary Research Questions**

- a. What is the historical background of FMS and DCS?
- b. What are the current FMS procedures for the acquisition of U.S. Defense articles and services?
- c. What are the DCS processes for the acquisition of U.S. Defense articles and services?

- d. How do bureaucratic constraints impact on FMS and DCS?
- e. What are the Turkish Navy's source selection criteria for the Acquisition of U.S. Defense Articles and Services?
- f. What are the price differences between FMS and DCS?
- g. What are the procurement lead-time differences between FMS and DCS?
- h. Which method (FMS or DCS) provides greater flexibility in contracting for U.S. Defense articles and services?
- i. Which method provides better follow-on support and training for the Turkish Navy?

## **E. RESEARCH METHODOLOGY**

The methodology used in this thesis research consisted of the following steps.

1. A literature search of books, magazine articles, Defense Acquisition Deskbook, General Accounting Office reports, and other library information resources.
2. Interviews with the Defense Institute of Security Assistance Management Agency, US Navy International Program Office Officials, Turkish Naval personnel, and defense contractors.
3. Review of U.S. Security Assistance, FMS and DCS processes.
4. Review of the Turkish Navy's source selection criteria.
5. An evaluation of the benefits and the deficiencies of DCS and FMS programs.

## **F. ORGANIZATION OF STUDY**

Chapter I discusses the background and objectives of the thesis.

Chapter II introduces the concept of Security Assistance and explains the history of the U.S. Security Assistance Program. It also describes the policies and procedures of the FMS and DCS processes for the transfer of U.S. weapon systems to foreign customers. It is designed to familiarize the reader with current regulations of the arms transfer process.

Chapter III analyzes the source selection criteria of the Turkish Navy for the acquisition of U.S. Defense Articles and Services. It emphasizes the Turkish Navy's priorities and constraints in choosing either FMS or DCS.

Chapter IV evaluates FMS and DCS and identifies their deficiencies and benefits for the Turkish Navy.

Chapter V concludes the thesis and presents some recommendations for the Turkish Navy.



## **II. BACKGROUND**

### **A. HISTORY**

#### **1. U.S. Arms Sales**

The transfer of arms has remained a vital part of global relations throughout human war fighting history. Historically, humans have sought to gain advantage over their opponent through military dominance. In this struggle for superiority, arms transfer has continued to play an integral role in all political relationships between trading nations. Although the desire to procure arms has continued, the mechanisms for transfer have changed depending on political climate and technological advancement.

In an attempt to delay or even avoid America's entry into World War II, President Franklin D. Roosevelt first offered U.S. military equipment to the United Kingdom through his "Destroyers for Bases Deal" in September 1940. Later that year in his "Arsenal of Democracy" speech, Franklin D. Roosevelt proposed a program whereby the United States would furnish necessary supplies, including food, machinery, military equipment, and services to all allies.

This proposal became the basis for Roosevelt's lend-lease program defined in his "Four Freedoms" State of the Union speech to Congress in January 1941. Congress subsequently authorized the Lend-Lease Act (1941) empowering the President to sell, lend, lease, and transfer such material under whatever terms the President deemed proper. This lend-lease program was originally intended to aid Britain, the Commonwealth countries, and China. [Ref. 5: p. 1]

By the war's end virtually all the allies, including the USSR, were recipients under this act. Between March and December 1941, Congress, in three separate actions, authorized a total of US\$23 billions in lend-lease. Lend-lease continued as an U.S. foreign policy tool through September 1946 authorizing a total investment of \$50.6 billions during the five-year program. [Ref. 6: p. 1]

By 1947, it became obvious that communist and capitalist ideologies would enter into hostile competition. The Soviet intention was to dominate and control as much of Europe as possible. The United States response centered around the containment policy of George Kennan the director of the State Department's Policy Planning Staff. A defined in "the long telegram," which argued that the main element of any United States policy toward the Soviet Union must be that of long-term, patient but firm, and vigilant containment of Russian expansive tendencies. [Ref. 7: p. 575] This policy became the foundation for the Truman Doctrine first presented in a speech to Congress on March 12, 1947. The Truman Doctrine committed the United States to containing communism throughout the world by aiding countries that requested help against Soviet expansionism. Its first test came in 1947 when the United States granted \$400 million to Greece and Turkey to fight the communist insurgency. This began the great arms race and international weapons sales competition. [Ref. 4: p. 18]

There was no big deviation from the U.S. Arms Export policy until the Vietnam War. The negative assessment of the Vietnam experience among Americans translated into an aversion to military aid, a practice that seemed likely to lead to other undesirable entanglements abroad. In the early 1970s, President Richard Nixon increased the emphasis on arms sales as a major policy instrument. Under the Nixon Doctrine, some of

the changes resulted from personal initiatives of President Nixon. In reaction to the Vietnam experience, sending arms instead of troops offered the Nixon administration a way to exert military influence throughout the Third World without taking on the political risks or paying the economic costs involved in direct military interventions like the one in Vietnam. [Ref. 11:p. 22] Nixon decided that the United States should reduce its presence abroad and—while maintaining treaty commitments and a willingness to provide security assistance—shift more of the burden for defense of other nations onto those countries themselves. In 1969, the President unveiled the Nixon Doctrine, under which the United States would “look to the nation directly threatened to assume the primary responsibility of providing the manpower for its defense.” [Ref. 14:p. 63] Nixon also believed that more of the costs of military assistance needed to be shifted abroad, leading to further efforts to replace grant aid with credits and sales.

In the authorizing legislation for military assistance in FY1974, Congress advised the Executive Branch to return arms transfers to commercial sales channels and to reduce FMS to the maximum extent (Foreign Assistance Act, 1973). The following year, the administration was directed to submit each pending foreign military sale exceeding \$25 million to Congress for approval in advance of consummation (The Foreign Assistance Act, 1974). Congress could then veto these sales if both Houses voted to do so within twenty days (it was later increased to 30 days). [Ref. 8:p. 16]

Congress further expanded its control over the arms sale programs in 1976. It initially passed legislation that would have placed an annual \$9 billion ceiling on all U.S. arms sales. President Ford vetoed this definite ceiling, but final legislation (PL 94-329) did contain an expression of the “sense of Congress” that foreign military sales should

not exceed "present levels." The compromise legislation signed by President Ford changed the title from "The Foreign Military Sale Act" to "International Security Assistance and Arms Export Control Act of 1976."

Those members of Congress who felt that U.S. arms transfers warranted greater control and scrutiny initially found an important ally in the executive branch in 1976. During the 1976 Presidential election campaign, President Carter was strongly critical of past U.S. arms transfer policies and promised, if elected, to take executive action to revise the U.S. roles in these areas. On 19 May 1977, President Carter issued a new executive policy on the U.S. role in the international transfer of arms. The strongly worded preface reiterated his desire for a reduction in the current U.S. role.

The public statement which was released attendant to Presidential Directive (PD) 13 indicated that arms transfers would henceforth be viewed as an "exceptional foreign policy instrument" and this policy objective would be implemented both through an annual ceiling on U.S. arms transfers and through multilateral discussions with other supplier and recipient countries. President Carter's stance, in sharp contrast to those of the Nixon and Ford Administrations, was the first initiative of its kind coming from the Executive Branch.

President Carter's commitment was insufficient to limit growth of US arms sales. Under the Carter Doctrine, US arms sales did initially decrease, but eventually rose to a record-level \$18.2 billions in 1979. In fact, the hallmark of the Carter administration was the multi-billion dollar arms credits given to Egypt and Israel for signing the Camp David Peace Accords. The result, which was completely contrary to stated policy, earned him the Nobel Peace Prize.

The Reagan administration's conventional arms sales policy was diametrically opposed to the Carter Doctrine. Reagan believed arms sales were integral to countering growing Soviet influence abroad. In July 1981, President Ronald Reagan formally approved his administration's policy concerning the transfer of conventional arms. Whereas the Carter policy regarded arms transfers as an exceptional implement, the Reagan policy viewed the transfer of conventional arms and defense equipment "as an essential element of its global defense posture and an indispensable component of its foreign policy."

A pivotal point of the Reagan policy was that the U.S. could not alone defend western security interests. Thus, the U.S. would heed the security requirements of friends and allies not as an alternative to an U.S. commitment or capability, but as a complement. The U.S. would assess the transfer of arms in light of the net contribution such transfers would make to U.S. global or regional security, thereby complementing and reinforcing the earlier Nixon Doctrine. [Ref. 2:p. 35]

The transfer of arms accomplished Reagan's overall goal; however, looking deeper, adverse effects began to emerge. The problems arose not from selling the weapons, but from those who received them. For example, arms transferred to Afghanistan ended up in the hands of Islamic mercenaries who later returned home to Iran and Libya, armed with high-tech U.S. weaponry for their terrorist movements. [Ref. 15] To make matters worse, the Pakistani Intelligence Directorate (ISI) decided who got the weapons transferred through Pakistan. Unfortunately, the preponderance of the weaponry went to a Moslem fundamentalist faction involved in the fight. [Ref. 16]

The Bush administration did not issue a distinctive conventional arms transfer policy. Rather, it continued the policy earlier promulgated under the Reagan administration in 1981. Illustrative of this similar policy approach is a statement from the Congressional Presentation prepared in 1991 by the Bush administration, which noted that "security assistance has long been an indispensable element in U.S. policy. [Ref. 17: p. 38]

In April 1990, President Bush issued a significant policy concerning a special phenomenon long associated with defense trade: offsets. Offsets are partial payments for arms purchases using goods and services in lieu of cash. As a matter of background, it had been Department of Defense (DoD)'s policy since May 1978 (dating back to the Carter administration) not to enter into government-to-government offset agreements because of the difficulties attendant to implementing such arrangements. [Ref. 18: para. 34,010] The Bush offset policy provided more explicit principles and guidance, and stated that any policy exceptions must be approved by the President through the National Security Council. Essentially the President's policy recognized that offsets had become a common feature of international trade and that this industrial and commercial compensation practice belonged within the realm of private industry. [Ref. 19]

More than any policy declarations, the global events that immediately come to mind relative to security assistance in the Bush administration are: the December 1989 collapse of the Iron Curtain and the subsequent emergence of democracy in the former Warsaw Pact countries; the August 1990 Iraqi invasion of Kuwait and the subsequent January/February 1991 Operation Desert Storm which liberated Kuwait. Operation Desert Storm demonstrated the effectiveness of American military might in a coalition

environment. It also validated the effectiveness of the U.S. security assistance program. For many years prior to Desert Storm, the United States had built up strong security relationships with friendly governments in the Persian Gulf as well as with other nations that joined the United Nations coalition.

Bill Clinton assumed the Presidency in 1993 with a full foreign policy plate. The humanitarian military mission in Somalia, the downward spiraling situation in Bosnia, sustained defiance by Saddam Hussein against UN sanctions on Iraq, a weakening U.S. economy and loss of predominance in the world's marketplace, the continued downsizing of the U.S. military, and the continuing saga of the Middle East peace talks, were some of the major challenges facing his administration. [Ref. 2]

President Clinton and his administration's policy did not represent a dramatic break with the written Reagan policy nor with President Bush's continued practice of that policy. In essence, the Clinton policy reinforced the concept that the transfer of conventional arms is a "legitimate instrument of U.S. foreign policy," which is deserving of U.S. government support in cases where it enables the United States to help allies and friends, as well as help support the U.S. industrial base. The policy, as described in a State Department message, gives increased weight to specific conditions in each region, following the changed environment of the post-cold war era. However, there is a second side to the Clinton policy: restraint. The White House fact sheet on the policy notes that "U.S. conventional arms transfer policy promotes restraint, both by the U.S. and other suppliers, in transfers of weapons systems that may be destabilizing or dangerous to international peace". [Ref. 20] Figure 2.1 summarizes the U.S. Arms Sales Policy of the last two decades.

<b>The Nixon Administration</b> (1969-1974)	<ul style="list-style-type: none"> <li>• The Nixon Doctrine</li> <li>• The emphasis on arms sales as a major policy instrument</li> <li>• Sending arms instead of U.S. Troops</li> </ul>
<b>The Ford Administration</b> (1974-1977)	<ul style="list-style-type: none"> <li>• The continuation of the Nixon Doctrine</li> <li>• The growing anxiety by the Congress over the U.S. arms transfers.</li> <li>• Arms Export Control Act (AECA) of 1976</li> </ul>
<b>The Carter Administration</b> (1977-1981)	<ul style="list-style-type: none"> <li>• The Carter Doctrine</li> <li>• The arms transfers was viewed as an "exceptional foreign policy instrument."</li> <li>• He wanted to reduce the U.S. Arms Sales.</li> </ul>
<b>The Reagan Administration</b> (1981-1988)	<ul style="list-style-type: none"> <li>• Arms sales were an essential and indispensable component of his foreign policy.</li> <li>• Arms sales were integral to countering growing Soviet influence abroad.</li> </ul>
<b>The Bush Administration</b> (1988-1993)	<ul style="list-style-type: none"> <li>• No deviation from the Reagan Administration</li> <li>• Change in the offsets agreements</li> <li>• Desert Storm</li> </ul>
<b>The Clinton Administration</b> (1993-..)	<ul style="list-style-type: none"> <li>• The transfer of conventional arms is a "legitimate instrument of U.S. foreign policy"</li> <li>• U.S. conventional arms transfer policy promotes restraint of arms transfers that may be destabilizing or dangerous to international peace</li> </ul>

**Figure 2.1 The U.S. Arms Sales Policy since 1969**

## **2. U.S. – Turkey Arms Sales**

Turkey is a key country for support of U.S. strategic interests in the European, Southwest Asian and Middle East areas. As a major ally, Turkey guards the North Atlantic Treaty Organization's (NATO) Southeastern flank and the critical passage from the Black Sea into the Mediterranean. Turkey is also adjacent to Bulgaria and Greece in the Balkans, and Iran, Armenia, Iraq and Syria in the Middle East. Turkey's support of NATO and U.S. strategic interests is multifaceted and reflects a strong commitment to meet all potential threats. Turkey has the second largest army in the Alliance and the percentage of the Turkish budget contribution to defense is the highest in NATO.

Depending on the current Defense and Economic Cooperation Agreement (DECA) with Turkey, the U.S. has access to Turkey's airfields, intelligence and communication facilities. Within this agreement, the U.S. has pledged to exert major and determined effort to furnish defense support for Turkey.

With the advent of the Truman Doctrine of 1947, the United States began a policy of constraining Russian expansionism. This doctrine led to a defensive policy between Turkey and the United States and ensured the eventual inclusion of Turkey into NATO. Since Turkey bordered Russia, the United States had an ally that could protect the Southeastern flank of NATO.

Subsequent to the implementation of the agreements between Turkey and the United States, Turkey began to receive various forms of aid. In July 1947, Turkey received \$122.5 million of economic aid and \$152.5 million in military assistance from the United States. This military assistance was used to enhance the posture of Turkey's Army, Navy and Air Force and to improve other militaristic facilities. Subsequent

agreements included the Military Facilities Agreement of June 1954 and the Defense and Economic Cooperation Agreement of March 1980. [Ref. 21:p. 9]

In 1964, the resilience of the defense relationship between Turkey and the United States was tested by the events surrounding the Cyprus conflict. Armed skirmishes in Cyprus led to a series of diplomatic attempts at resolving the conflict. After several failed attempts in 1964, Turkey contemplated military intervention in June 1964. The United States forestalled this intervention by issuing what was commonly referred to as the "Johnson Letter." In this letter, President Lyndon B. Johnson heatedly warned that the U.S. would refrain from honoring its commitment to defend Turkey if the Soviet Union carried out its threat to attack the NATO ally in response to Turkish intervention in Cyprus. [Ref. 27:p. 9]

The dilemma posed by Cyprus and Greece, which had plagued Turkey-U.S. defense relations since 1964, reached a new climax in the summer of 1974. A Turkish military intervention in Cyprus on 20 July 1974 led to an arms embargo imposed by the United States under the grounds that Turkish utilization of U.S. bought arms violated the U.S. Foreign Assistance Act of 1961 and the Foreign Military Sales Act. This embargo took the form of withholding crucial spare parts and other necessary logistical apparatus. Thus, the United States embargo significantly affected the logistical base of the Turkish military and emphasized Turkey's reliance on American militaristic support. The effects of the Cyprus conflict, the arms embargo and the Greek-Turkish hostility brought American-Turkish relations almost to a breaking point until a new defense agreement was signed on 30 March 1980. From 1980 to 1997 Turkey received more than \$6.5 billion in the form of grand aids and direct loans. During the same period, Turkey took delivery of

\$8.861 billion in weapon systems/services from U.S. through FMS or DCS. [Ref. 26]

Between 1990 and 1992, Turkey's importance to the United States reasserted itself as a consequence of the Gulf War. The United States recognized the importance of Turkey as it spearheaded combat operations directed against the Iraqi threat. Beginning in August 1990 and lasting until December 1991, Turkey gave its full support for Operation Proven Force - the air combat operations conducted from Turkey as an adjunct of Operation Desert Shield/Desert Storm - and for Operation Provide Comfort - the coalition effort to provide humanitarian relief to more than 500,000 Kurdish refugees who fled from the Iraqi forces of Saddam Hussein into southeastern Turkey. [Ref. 27:p. 10]

## **B. THE CURRENT FOREIGN MILITARY SALES POLICIES AND PROCEDURES**

### **1. Basic Policies**

Exporting American ideas, equipment, training and doctrine is nothing new and has numerous benefits for U.S. security interests. Two of the most recognizable benefits are U.S. access and influence. Since the end of the Cold War, there has been an apparent shift in U.S. Government policy to sell more high-technology military equipment as opposed to the older, more outdated, retired U.S. military equipment. As U.S. defense spending continues its downward spiral, the U.S. is unable to fully support its military industrial complex. Today, FMS contracts are the only procurements keeping many U.S. weapons production facilities open to preserve and protect the U.S. defense industrial base.

To successfully implement any FMS contract, the U.S. established a group of government procedures and policy. These procedures are set forth in the Arms Export

Control Act (AECA) of 1976 and DoD Instruction 5105.38-M, Military Assistance and Sales Manual (MASM). FMS procedures must meet the basic tenets of the MASM. [Ref. 22: sec. 20202-A] These tenets are:

- Recognize the increasing cost and complexity of defense equipment and the continued need for international defense cooperation to maintain peace and security.
- Establish the policy that sales will facilitate the common defense by entering into international arrangements with friendly countries on projects of cooperative exchange of data, research, development, production, procurement, and logistics support to achieve national defense requirements and objectives of mutual concern.
- Declare that the AECA authorizes sales that further US security objectives to friendly countries to equip their forces with due regard to the impact of sales on social and economic development and on arms races.
- Declare the sense of the Congress that all such sales be approved only when they are consistent with US foreign policy interests.

## **2. Initiation**

There are some general rules to be followed in implementing an FMS case. The following represents the general procedures that are typically followed, starting from foreign customer interest to final case closure.

There are two fundamental pre-conditions for initiating an FMS project:

The first one is that any country desiring to buy or lease military articles or services must be eligible, by presidential approval, for FMS goods and services. [Ref. 22: sec. 20301] Eligibility requirements are:

- Unless the President finds that national security requires otherwise, he shall terminate all assistance, sales, credits and guaranties to any government, which aids or abets (by granting sanctuary from prosecution) any individual or group, which has committed an act of international terrorism. [Ref. 23:sec. 620A, and Ref. 24:sec. 3(f)]
- Assistance will be suspended for countries, which have nationalized, expropriated, or seized US property, or have imposed discriminatory taxes. Assistance is also to be suspended if a country has initiated steps to repudiate or nullify existing agreements with US citizens or entities without taking proper compensatory action. [Ref. 23:sec. 620(e)]
- The purchaser or grant recipient must agree not to transfer title or possession of any defense article or related training or other defense services to any other country without prior US consent. The President must report to the Congress before such consent is given. [Ref. 24:sec. 3(a)(2), and Ref. 23:sec. 505(a)] Special care must be taken to ensure that minor repair parts, fuel, or other defense articles which lose identity when co-mingled, are controlled by the recipient government using a procedure which will reasonably assure there will be no non-approved transfers.
- Sales and assistance may be made to countries only for purposes of internal security, legitimate self-defense, civic action, or regional or collective arrangements consistent with the United Nations (UN) Charter, or requested by the UN. [Ref. 24:sec. 4, and Ref. 23:sec. 502]
- Assistance may be provided to Communist countries only if the President exercises his waiver authority under section 614(a) FAA, and concurrently finds and reports to Congress that such assistance is vital to the security of the United States and promotes the independence of the recipient country from international communism. [Ref. 23:sec. 620(f)]

- Economic and military assistance and sales to a country will be suspended if the President determines the government of that country has failed to take adequate steps to prevent either the sale of illegal drugs or other controlled substances to US government personnel or their dependents or the smuggling of such narcotics into the United States. [Ref. 23:sec. 481(h)]
- Any government using American equipment and/or services in substantial violation of an applicable agreement entered into under US law with that government shall be made ineligible for future US assistance until such time when the President determines that such violations have ceased and has been assured that they will not recur. [Ref. 23:sec. 505(d) and Ref. 24:sec. 3(c)]

And as a second pre-condition, the requested article or service must also be on the relevant Military Articles and Services List (MASL). MASL contains information submitted to Defense Security Assistance Agency (DSAA) by the supplying agencies with identification and availability of defense articles and services. The MASL provides a uniform level of line item detail for the automated Security Assistance programs of all agencies.

The foreign customer, after meeting the above conditions, becomes eligible and prepares a simple request in the form of a letter to the U.S.

### **3. Letter of Request**

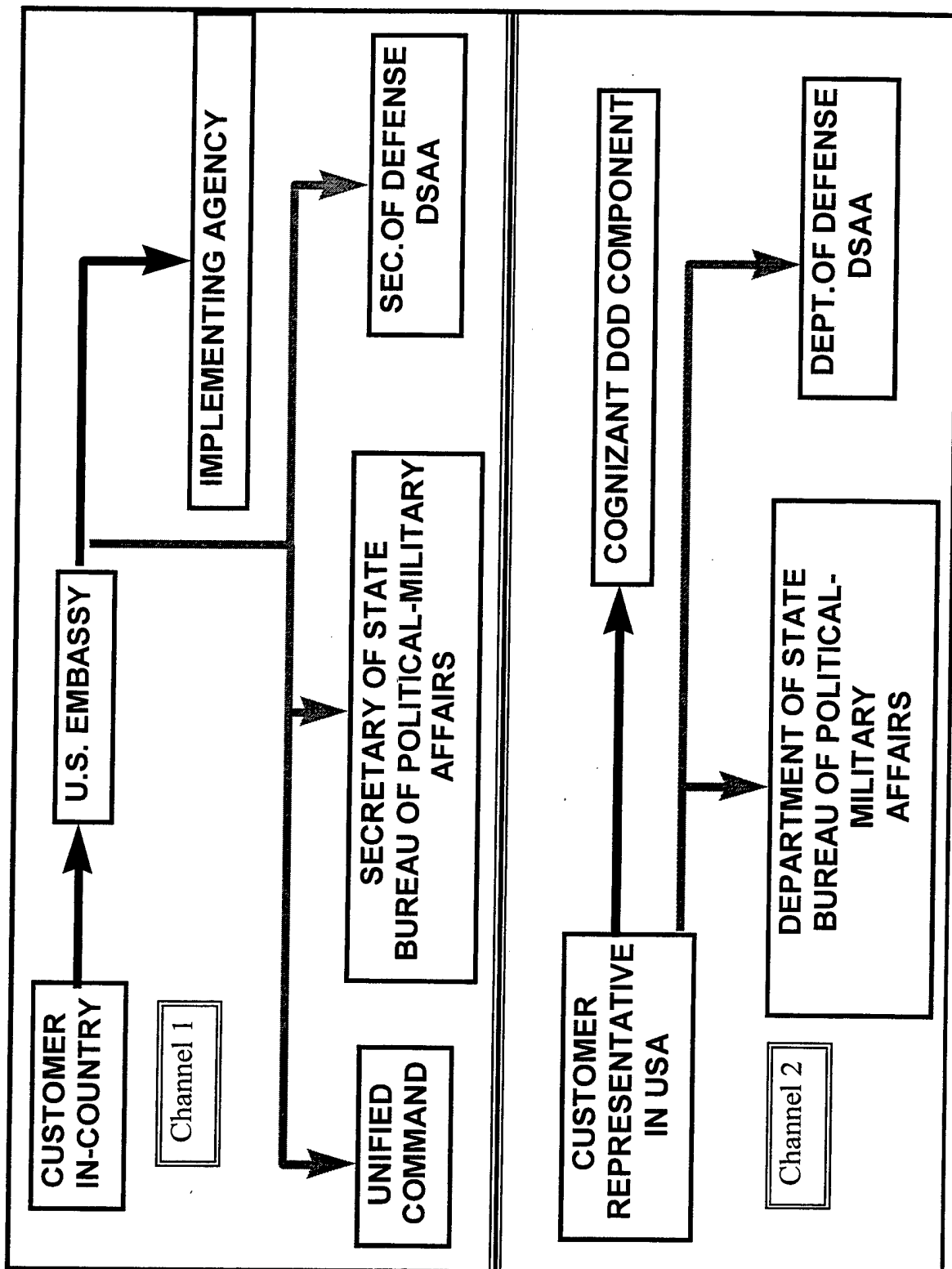
The life cycle of an FMS case begins with a request by an eligible foreign country for item data from the U.S. Government. FMS offers are made only in response to a foreign customer's initiative, in the form of a Letter of Request (LOR), a formal diplomatic letter requesting articles, military construction, or other services. Such an

LOR must be reviewed and validated by the military department, Defense Security Assistance Agency (DSAA) and the Department of State, to ensure that the prospective FMS purchaser is eligible, that the articles/services may be sold, and that the request went through proper channels.

While formal action must wait for receipt of an LOR, it is often prudent to prepare for an expected LOR prior to its actual arrival. In particular, an implementing agency may be requested to assist a prospective FMS customer in planning and requirements validation. This is done to ensure that the LOR will request equipment and services, which will meet the customer's requirement. It will also help result in an LOR which is as clear and complete as possible, and which includes required content, as outlined in the Security Assistance Management Manual (SAMM.)

The channels used are based upon whether the request is for "Significant Military Equipment (SME)" or for "All other FMS (non-SME)" requirements. SME are items designated in the International Traffic in Arms Regulation (ITAR) that warrant special export controls because of their capacity for substantial military utility. Requests for defense equipment (any item of Significant Military Equipment having a non-recurring research and development cost of more than \$50 million or a total production cost of more than \$200 million) are treated as requests for SME. Figure 2.2 shows the two channels of submission for an LOR. [Ref. 2:p. 147]

It is in the best interest of the U.S. Government and the potential FMS customer that an U.S. agency assists the customer in requesting a realistic program that meets their requirements, budget, a realistic schedule and support program. The following key considerations should be addressed: [Ref. 2:p. 164]



**Figure 2.2 Two Channels of Request for Significant Military Equipment (SME)[Ref. 2: p. 163]**

Note: The channels of request for non-SME requirements are identical to the above, except for the omission of the U.S. Embassy channel.

- Delivery schedule,
- Total program cost,
- Personnel availability and expertise,
- System availability,
- Continued logistics support availability,
- Relationship between the proposed FMS case and other US Security Assistance programs,
- Status and credit availability,
- Other US team support for the requested case,
- Foreign Disclosure Policy.

*a. Requests for Significant Military Equipment (SME)*

Requests to purchase SME, which originate in-country, should be transmitted by the U.S. Embassy rather than by the Security Assistance Office (SAO) or a similar military element of the Embassy. These requests must be addressed to the implementing agency, with information copies to the Bureau of Political Military Affairs, Department of State (SECSTATE/PM), the Office of the Secretary of Defense, Defense Security Assistance Agency (SECDEF/DSAA), and the Unified Command. Requests to purchase SME which originate with purchasing country representatives in the United States should also be addressed to the cognizant Department of Defense (DoD) component with information copies to SECSTATE/PM and to DSAA. [Ref. 2:p. 157]

The U.S. Embassy provides an assessment of the proposed sale to include a statement of the reason the nation desires the weapon systems and the anticipated reaction of neighboring nations.

***b. All Other FMS (non-SME)***

Requests for non-SME originating in the purchasing country should be transmitted either by the customer country's authorized representative or the DoD element of the U.S. country team directly to the implementing agency. Requests originated by foreign representatives of the customer country in the U.S. should be sent directly to the cognizant DoD component. [Ref. 2:pp. 147-149]

***c. Military Articles and Services List (MASL) Validation***

Before any further action is taken on the LOR, it must be validated to insure the potential customer is an eligible FMS recipient and that the article or service sought may be sold. DSAA maintains a Military Articles and Services List (MASL), which is distributed to agencies who prepare Letters of Acceptance (LOA). It provides a generic listing of the military articles and services offered under FMS. If a requested item does not appear in the MASL, then a policy-level decision must be made before the item may be added to the MASL and offered for sale. [Ref. 2:p. 153]

***d. Acknowledgement of LOR***

Formal acknowledgment to the customer of receipt of a valid LOR is required within five days of such receipt by the military department (MILDEP). An LOR may be submitted directly to State or DSAA if it is deemed to be of such a sensitive nature that higher level review is required. Based upon receipt of the information copies of the LOR, State and DSAA will, within five working days, initiate the necessary coordination to determine if there will be any objection to the proposed sale.

While there is no standard format for an LOR, there is some common content that should be included. The LOR should state clearly if it is a request for Price and Availability (P&A) data, or a request for a Letter of Offer and Acceptance (LOA). [Ref. 2:p. 159]

#### **4. Price and Availability (P&A) Data**

Price and Availability (P&A) estimates reflect rough order of magnitude data; they are provided for planning purposes only, and show estimated costs and projected availability of defense articles or services. P&A data will normally be provided within 45 days of receipt of an LOR. P&A estimates are not normally valid for the preparation of an LOA, and such preliminary data will not serve as a basis for constructing an LOA.

DoD components should ensure that P&A data are sufficiently accurate for planning purposes, although not necessarily for budgeting. When DSAA approval is provided (within five working days of receipt of the request, unless otherwise advised), no further staffing with DSAA is required. [Ref. 2:p. 159]

#### **5. The Letter of Offer and Acceptance (LOA)**

The LOA is the official document used by the U.S. Government (USG) as an offer to sell defense articles and services to a foreign country or international organization. The LOA must provide sufficient information to clearly delineate the obligations of both the U.S. and the customer. The type and amount of information required may vary from case to case. The offer becomes a contract when it is accepted by a representative of the purchasing country or international organization, stipulating the terms and conditions pertaining to the case. Required information, which is supplemental

to the standard annexes, is provided in the form of explanatory notes. The LOA provides standard terms, conditions, and necessary information.

Implementing Agencies (IAs) are those USG agencies authorized to receive LORs. In accordance with DoD policy, the applicable IA should write the LOA within 60 days after receipt of the LOR and forward it to DSAA for countersignature. After countersignature, the IA then forwards the LOA to the customer for acceptance. The three kinds of LOAs or "cases" written by the IAs are described below. [Ref. 2:p. 160]

*a. Defined Order*

A "defined order" case is one in which the defense articles, services, or training requirements are specified/quantified by the purchaser in the FMS customer's LOR. These cases are often referred to as "Defined Line or Push Requisitioning" by the U.S. Navy. [Ref. 2:p. 213]

A "defined order" case normally requires a complete LOA data study of separately deliverable line items. This study can range from extensive efforts, including contacts with potential contractors, to determining the latest most representative procurement price, when applying an appropriate inflation factor.

The types of defense articles, services, or training normally processed as "defined order cases" are shown below:

- System/Package Sales include major items and weapon systems (e.g., tank, ship, airplane, missile, etc.) and any related requirements to activate and operate an item or system during an initial period of time,
- Munitions, Ammunition and other Explosives,
- Transportation Services,

- Aircraft Ferry,
- Cartridge Actuated Devices/Propellant Actuated Devices,
- Technical Data Packages.

***b. Blanket Order***

A "blanket order case" is an agreement between a purchaser and the United States Government for a specific category of items or services with no definitive listing of items or quantities. The LOA specifies a dollar ceiling against which orders may be placed. Customers may requisition against a "blanket order case" as long as funds are available. These cases are commonly called "Direct Requisitioning Procedures/Open End Requisitioning" or "Pull Requisitioning" by the U.S. Navy. [Ref. 2:p. 214]

The "blanket order cases" are normally used to process the following items:

- Spares and Repair Parts,
- Publications,
- Support Equipment,
- Minor Modifications Alterations Performed at U.S. Military Installations,
- Technical Assistance Services,
- Training Aid Devices,
- Repairables.

*c. Cooperative Logistics Supply Arrangement (CLSSA)*

CLSSA is a military logistics support arrangement designed to provide responsive follow-on support for U.S. produced military hardware possessed by foreign countries. Military departments may offer a CLSSA to a customer on approval from the DSAA. [Ref. 2:p. 216]

The Cooperative Logistics Supply Support Arrangement (CLSSA) program provides essential follow-on spare-part support to U.S. Security Assistance customers. It provides optimum support for purchases of major defense equipment and the maintenance of older generation equipment. It is the only available method used by participating customers to buy into the U.S. logistics system for the purpose of replenishing in-country inventories while significantly reducing the procurement lead time. The CLSSA stocked National Stock Numbers (NSN) are normally issued when requisitioned within 30-60 days.

DoD considers the CLSSA to be one of the most effective means to replenish the in-country stocks of spares and repair parts, which were initially furnished with end items of equipment. It is also normally the most responsive means through which authorized repair parts may be obtained.

The CLSSA is an FMS agreement for the furnishing of secondary items from the U.S. logistics system to a country in support of specific major end items/systems. The arrangement requires the country to make a financial investment in the DoD logistics system to establish equity representative of its anticipated support requirements. The country, in conjunction with the recommendation of the system program managers, identifies by stock number and quantity those common use items

which the country anticipates it will require over a given period (normally between 12 and 24 months, depending upon the Military Department (MILDEP) implementing the CLSSA), to support a weapons system/major end item. This list is known as the equity list, because of the customer investment in the U.S. supply system. The investment permits the U.S. service to augment its stocks in anticipation of the country's actual demands. The CLSSA is used only for replenishment of consumables and for replacement of repairable components, which are either not provided with the initial support package or which are beyond repair. It is not intended for increasing in-country stocks or for initial support.

#### **6.     Compilation of LOA Data**

The actual LOA data estimates are made by the applicable service program/system/item manager. They are based either on contractors' quotes or on the current or projected cost and availability of the desired items. A key element in obtaining complete LOA data is the identification of each of the required items and services. For the Navy, the primary responsibility for this identification usually rests with the Navy Systems Commands for major system cases.

Generally, it is the responsibility of the FMS case manager within these agencies to obtain and review the necessary detailed data on costs, schedules, configuration, and other factors for preparing an FMS proposal. The proposal is coordinated with other activities. The scope of these activities, the time involved, and the level at which they take place depend on a number of factors - political, as well as technical and financial.

[Ref. 2:p. 166]

The officer designated by the implementing agency writes the LOA. Within the Navy, they are written by the International Programs Office (Navy IPO).

## **7. Final Review of LOA**

### ***a. DSAA Countersignature***

The DoD components should forward the LOA to the DSAA Comptroller for countersignature prior to release to the customer. Those cases, which must be presented to Congress also, undergo this DSAA policy review process. The DSAA review for such cases begins within ten working days after the LOA preparation has begun, or as soon as it is anticipated that the offer will meet one of the congressional reporting thresholds. [Ref. 2:p. 160]

### ***b. Department of State (DoS) Review***

The DoS is responsible for the approval of all proposed sales prior to the notification to Congress. The DoS authorizes DSAA to furnish Congress advance notification of each sale. The advance notification, which is an informal requirement, provides for a 20-calendar day preliminary congressional examination period. (This advance notification is not required for NATO members, Australia, Japan or New Zealand.) After 20 days, DSAA submits the formal 30-day (15-days for NATO members, Australia, Japan or New Zealand) notification to the Congress as required by Section 36(b) of the AECA. The potential purchaser is normally provided a courtesy copy of the unsigned LOA as a matter of information. [Ref. 2: p. 172]

*c. Other DSAA Coordination Actions*

As a final check, a list of proposed LOAs to be issued is compiled by DSAA for review by the Department of State Bureau of Political-Military Affairs. Following this action, if no objections are encountered, and if Congress does not object to the proposed sale within 30 (or where applicable 15) calendar days, the DSAA Comptroller "countersigns" the LOA and forwards it to the cognizant DoD component for submission to the requesting government. At the same time, a copy is sent to the Defense Finance and Accounting Service--Denver Center, Directorate for Security Assistance (DFAS-DE/I). [Ref. 2:p. 161]

**8. Acceptance of Offer by Purchaser**

If the offer is acceptable, the customer is normally given 60 days to complete and sign the LOA, and forward copies to the military department and DEFAS-DE/I with any required initial payment on or before the expiration date listed on the offer. Within five days of acceptance or rejection, the SAO or signature authority for the LOA should advise DSAA, DEFASDE/I, and the IA of the status of the LOA. [Ref. 2:p. 173]

**9. FMS Pricing**

The methodology employed in determining an FMS price depends on whether the price is to be fixed or estimated in the LOA. In either case DoD personnel responsible for pricing and reporting costs must refer to DoD Instruction 7000.14-R, Volume 15, for current policy and procedures. The basic methodology involves the determination of a base cost (e.g., stock, inventory, procurement) plus other costs (e.g., administrative charge, accessorial charges etc.). Although the pricing methodology is relatively simple,

estimating the cost elements (i.e., "how much" or "to what extent") for allocation to an FMS price can be difficult. Figure 2.3 shows the price formula for FMS.

The LOA is the primary document used to transmit FMS prices to the purchasing country. Elements used in calculating FMS prices may include, but are not limited to the cost of the item, non-recurring research and development (R&D) and production costs, contract administration costs, accessory charges and administrative charges. The above charges can be combined into two categories: base price and authorized surcharge. Base prices include cost of item or service, while the authorized surcharge represents a percentage of the base prices.

Authorized surcharges are required by AECA of 1976 in order that the FMS customers pay a fair share of the overhead and other costs that have been incurred by the USG as a result of providing goods and services. To satisfy this requirement, an "administrative surcharge" of three percent is applied to most FMS cases. A five percent rate is applied to non-standard articles and supply support arrangements. In addition, a "logistic support charge" of 3.1 percent is also applied on certain deliveries of spare parts, equipment modifications, secondary support equipment and supplies.

#### **10. Implementation of the Case**

After receiving the initial deposit, DFAS-DE/I releases the obligational authority (O/A) to the cognizant DoD component. The O/A is evidence that proper case acceptance, including cash deposit, has been received and the case may be implemented. A typical program involves the procurement of items from new production, as well as the provision of selected items from government stocks. Items to be procured are contracted

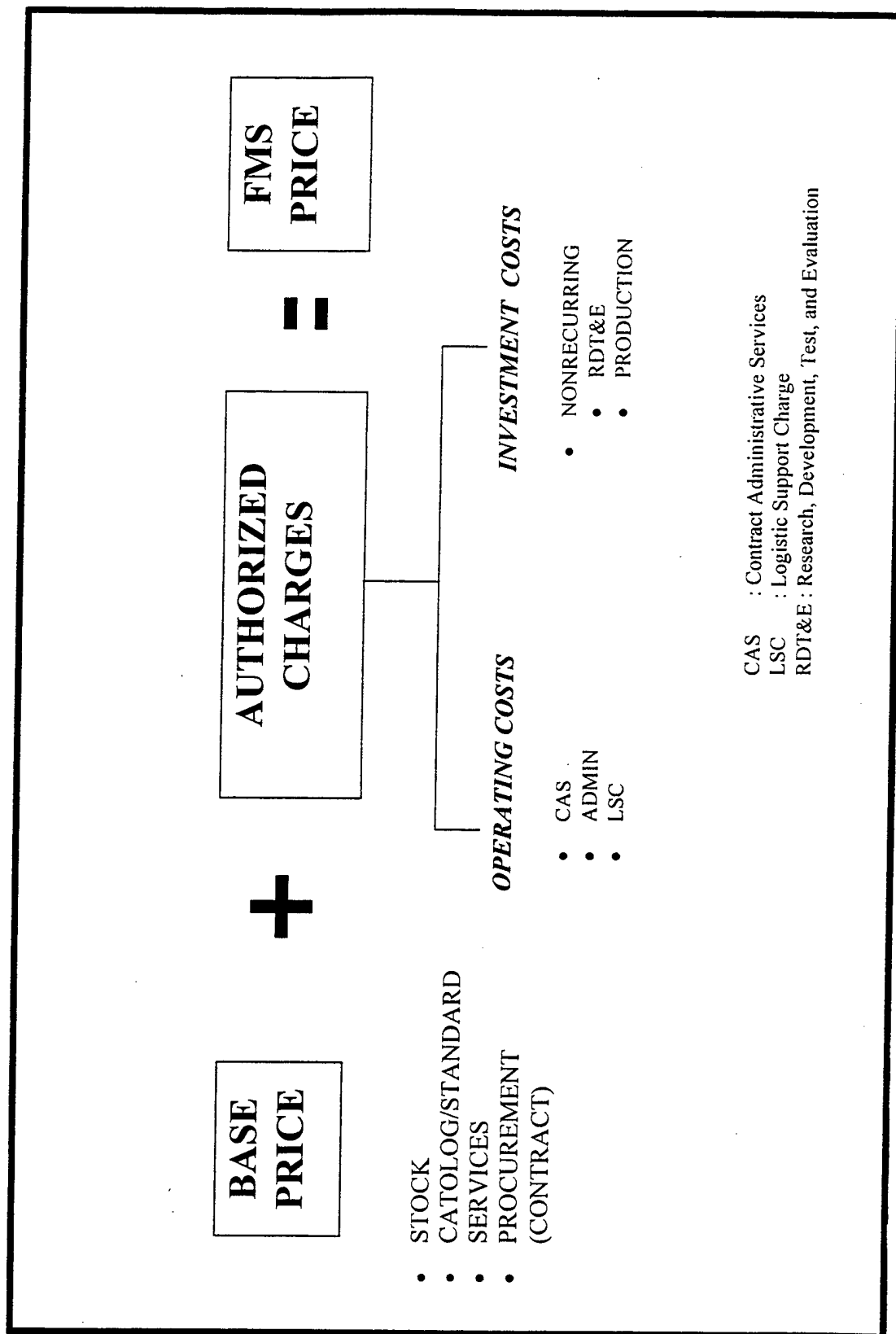


Figure 2.3 FMS Pricing Formula [Ref. 2:p. 368]

from industry by cognizant Government buying activities. FMS requirements may be consolidated with USG requirements or placed on a separate contract, whichever is more expedient and cost effective. Figure 2.4 is a sample timeline for the major events that may occur in the entire FMS process cycle. [Ref. 2:p. 173]

The actual procurement and supply actions for the FMS program are carried out by USG procurement and logistics activities using largely the same internal management organizations as for USG programs. The Implementing Agencies may establish separate offices or positions within their organizations to provide overall surveillance of the FMS program, and they serve as an interface with other organizations involved in managing the program. [Ref. 2:p. 162]

Some FMS customers have chosen to establish small liaison offices within the USG program management offices and the contractors' facilities as well. Liaison offices are also located at inventory control points and International Logistics Control Offices (ILCOs). Each military department has a central supply and/or financial control organization generally called "ILCOs." This organization is the Navy International Logistics Control Office in Philadelphia, PA for the U.S. Navy. When all items and services listed in the LOA have been shipped or performed, an FMS case is considered supply complete or delivered and is then ready to undergo the FMS case closure process.

## **C. DIRECT COMMERCIAL SALES (DCS)**

### **1. Basic Policy**

DoD generally has no preference as to whether a foreign country fills its valid defense needs through FMS or commercial channels. Moreover, DoD tries to accommo-

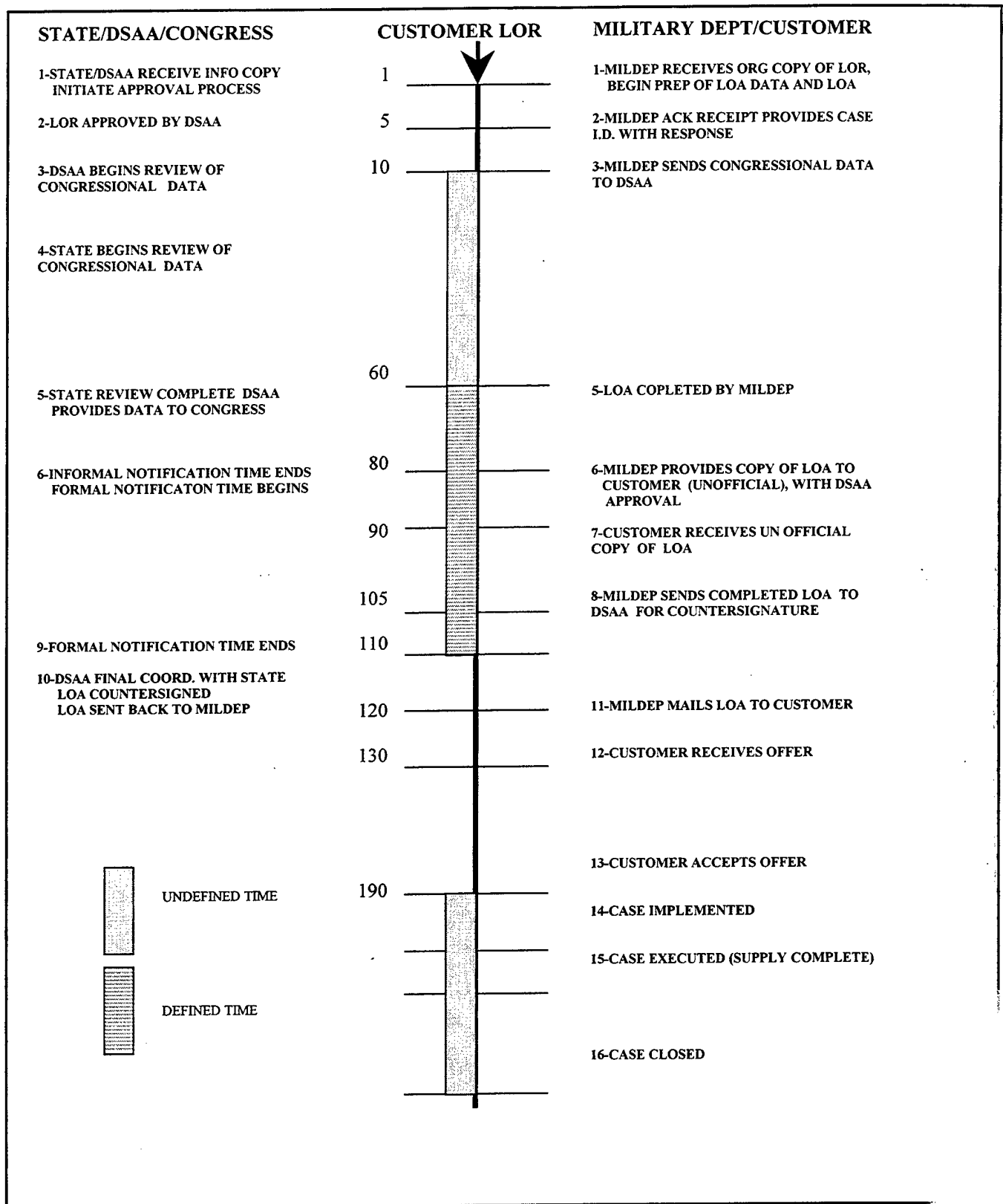


Figure 2.4. FMS Process (Days)[Ref.2:p.181]

date an U.S. contractor preference for direct sales if such a preference is indicated by the contractor, unless the host country requests FMS. DoD policy also provides that price quotes will not normally be provided for comparison of FMS with DCS. [Ref. 22: sec. 60202] For the most part, the controls over arms sales do not distinguish between whether a sale is FMS or DCS. The same government offices review both DCS and FMS requests and apply the same criteria, including the President's arm transfer restraint policy.

## **2. Procedures**

The AECA of 1976 authorizes the sale of military equipment by the U.S. Government to friendly countries and regulates the commercial export of defense articles. The controlled articles are identified in the U.S. Munitions List (USML) and Published in the International Traffic in Arms Regulation (ITAR). The commercial export of military equipment requires an export license.

DCS is licensed under the AECA of 1976. The Foreign Assistance Act (FAA) of 1961 (Section 502B) perspective includes DCS as an element of security assistance for Congressional oversight purposes. A DCS licensed under the AECA of 1976 is a sale made by U.S. industry directly to a foreign customer. Unlike the procedures employed for FMS, DCS transactions are not administered by DoD and do not involve a government-to-government agreement. Rather, the U.S. Governmental "control" procedure is accomplished through licensing by the Office of Defense Trade Control (DTC) in the Department of State. DTC reviews all requests for licenses and other approvals to export defense articles, services or technical data; establishes licensing

policies and procedures; and enforces compliance with the International Traffic in Arms Regulations (ITAR). [Ref. 2:p. 55]

Such licensed sales are authorized under Section 38 of the AECA of 1976. The day-to-day rules and procedures for these types of sales are contained in the ITAR, which includes the United States Munitions List (USML).

### **3. Getting Help from U.S. Government**

Eligible governments may request contract administration and contract audit functions normally provided by DoD contract administration offices and the Defense Contract Audit Agency (DCAA) auditors. The procedure is for the foreign customer to submit a request for such services to the Defense Contract Management Command International (DCMCI), New York, which has been designated as the DoD Central Control Point (DoDCCP) and is responsible for arranging DCS contract administration and contract audit services.

This service for DCS purchases is normally authorized and reimbursed through an FMS case for blanket order Letter of Offer and Acceptance (LOA) between the foreign customer and the U.S. Government (DoDCCP). The LOA establishes an estimated dollar value against which individual requests can be placed throughout a specified ordering period. The DoDCCP may also prepare an LOA to respond to a foreign customer's request for services that are applicable to a specific contract.

## **D. SECURITY ASSISTANCE (SA) RELATED TO AUTHORIZATION AND APPROPRIATION ACTS**

Security Assistance (SA) programs and their funds must be authorized and appropriated by the U.S. Congress. Authorization and Appropriation acts related to SA are as follows;

### **1. Authorization Acts**

The main laws related to U.S. SA programs are: (1) the Foreign Assistance Act (FAA) of 1961 as amended, and (2) the Arms Export Control Act (AECA) of 1976 as amended.

#### ***a. The Foreign Assistance Act (FAA)***

FAA authorizes legislation for a wide variety of foreign assistance programs including International Military Education and Training (IMET,) overseas assistance program management, and transfer of excess defense articles (EDA).

#### ***b. The Arms Export Control Act (AECA)***

This act was known as the Foreign Military Sales Act of 1968 (FMSA). The title was changed to AECA by the International Security Assistance and Arms Export Control Act of 1976. The AECA provides the regulations for the conduct of FMS funding. Figure 2.5 shows the historical and structural evaluation of the authorization process.

### **2. Appropriations Act**

Appropriations for Security Assistance are included in the annual "Foreign Operations, Export Financing, and Related Programs Appropriations Act" for each year.

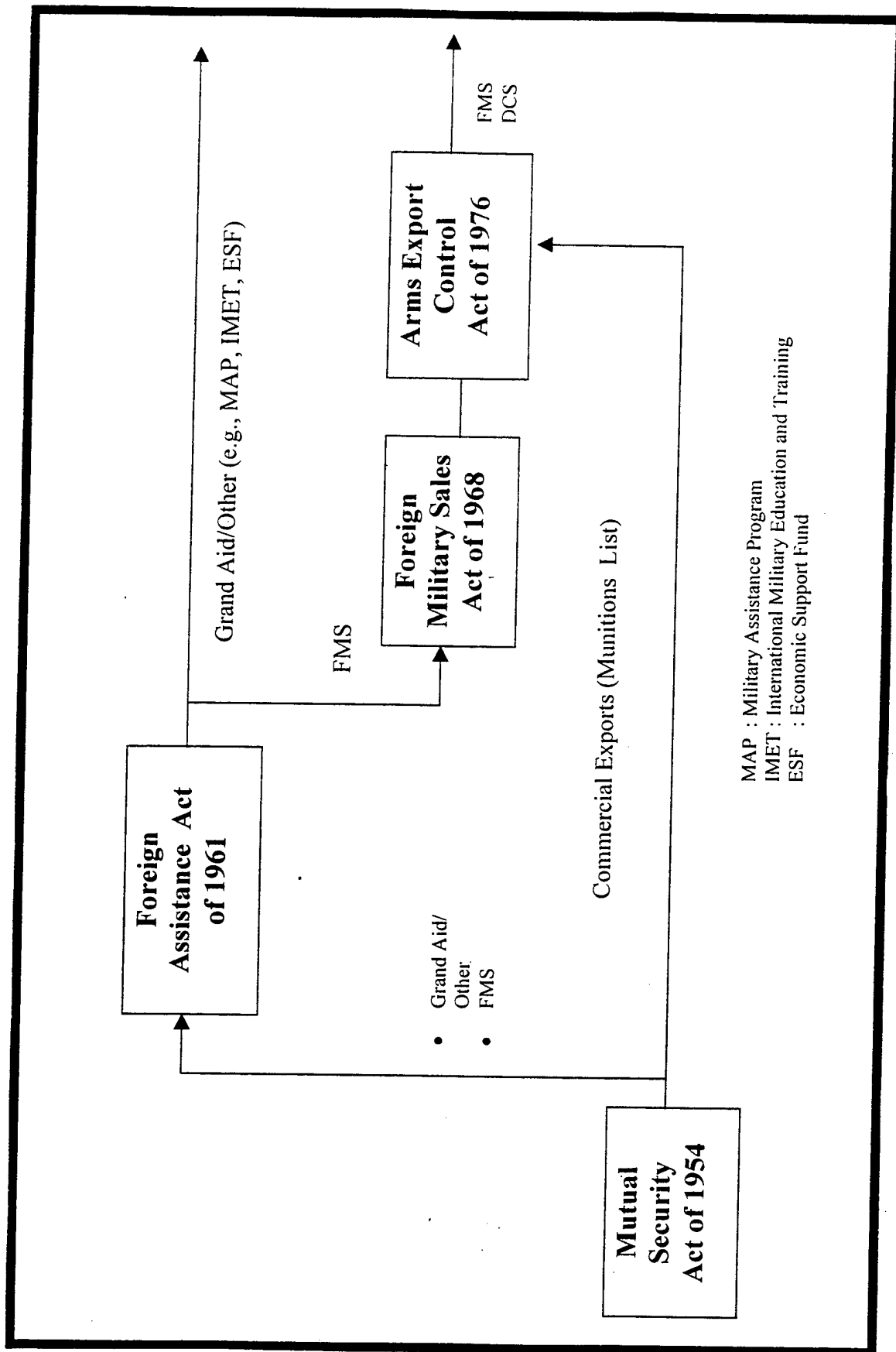


Figure 2.5 Major Security Assistance Authorization Acts since 1954 [Ref. 2:p. 62]

## **E. CONGRESSIONAL ACTIONS**

The President is required by the AECA of 1976 to notify Congress of certain defense trade export applications prior to their approval. The FMS and DCS review provisions are shown in Figure 2.6. [Ref. 2:p. 62]

### **1. Foreign Military Sales/Leases**

The AECA of 1976 requires that, before issuing a letter of offer to sell or lease agreement to:

- Lease defense articles or services for \$50 million or more, or
- Any design and construction services for \$200 million or more, or
- Major defense equipment for \$14 million or more.

The President must submit a certification to the Congress. The LOA or lease agreement can be issued by the Government if the Congress does not have an objection within 30 calendar days after receiving such certification. However, if an imminent requirement (in the national security interest of the U.S.) exists for the lease, the Government might start the process without waiting 30 days and the President states this in his certification. [Ref. 25:sec. 61,62]

To provide the Congress with sufficient time to review such cases, the Defense Security Assistance Agency (DSAA) has agreed to provide the Congress 20 days advance notification of such cases prior to the formal submission of the 30-day statutory notification. [Ref. 22:sec. 601]



An exception to the above procedure exists for NATO countries, Japan, Australia, and New Zealand. The formal statutory notification period for these countries is 15 days, and the advance notification is not required.

## **2. Direct Commercial Sales.**

Thirty days before the issuance of any export license for Major Defense Equipment in excess of \$14 million or other defense articles/services in excess of \$50 million, the President shall submit a numbered certification to the Congress. Unless the President states in his certification that an emergency exists, an export license for the items shall not be issued within a 30-calendar day congressional review period. Further, such license shall not be issued if the Congress, within such 30-day period, adopts a joint resolution objecting to the export. The Congressional review period for NATO members, Australia, Japan, and New Zealand is 15 days as in the FMS process. [Ref. 24:sec. 36(c)]

## **3. Congressional Joint Resolutions**

The mechanism for the rejection of proposals by the legislative power is known as joint resolution. A joint resolution covers the disapproval of a proposed sale, transfer, or lease, which is passed by simple majority votes in both the Senate and the House of Representatives.

Such a joint resolution must be sent to the President for review and approval. Since the President is unlikely to approve the rejection of an action, which his Administration originally proposed to Congress, the President will likely veto such a joint resolution, returning it to Congress.

Unless Congress is able to override the President's veto by obtaining a two-thirds majority vote in each House in support of the original resolution of rejection, the sale, transfer or lease will be permitted. However, if Congress can muster sufficient votes to override the President's veto, the proposed sale, transfer, or lease would die.



### **III. SOURCE SELECTION CRITERIA OF THE TURKISH NAVY FOR FOREIGN MILITARY SALES(FMS) AND DIRECT COMMERCIAL SALES(DCS)**

#### **A. BACKGROUND**

##### **1. History**

The Turkish Navy (TN) was established after the Selcuk Turks settled in Anatolia in 1071. With the establishment of the Ottoman Empire the Ottomans embarked on an ambitious military build-up program not only for land forces but also to project power at sea. They upheld their strategic, economic and military interests at sea and sustained the security of their sea lines of communications (SLOC). Thus the Turkish fleet became the predominant naval power in the Mediterranean Sea. During this period, Turkish seaman were not only successful in maritime warfare but they also significantly contributed to the world's knowledge of the sea. For example, the first global naval chart and a guidebook were written by a famous Turkish seaman Piri Reis. [Ref. 29:p. 35]

The decline of the Empire was paralleled by the diminishing strategic importance of the Navy. Notwithstanding its fading role, the Navy carried out vital missions in the War of Independence and played an important part in the victory.

After the establishment of the Republic of Turkey in 1923, a peninsular country, efforts were made to develop and modernize the TN. Endeavors to improve the service gained momentum as a result of the creation of the Naval Forces Command in July 1949, which led to the building of shipyards, training and supply centers. Today, various modernization programs are in progress in order to achieve the TN's goal "to maintain a modern and effective navy."

## **2. New Environment and Maritime Strategy**

The recent historic changes have significantly improved the overall security of Turkey. However, a great deal of uncertainty about the future still remains. The geographical attributes of Turkey have always placed a heavy burden on the TN's maritime strategy. The dissolution of the Soviet Union made Turkey the epicenter of a very volatile region facing multi-directional and multi-faceted risks in the new security environment. [Ref. 28:p. 65]

The fundamental changes in this environment and in the nature of the threat have affected Turkey's maritime strategy on a large scale. International agreements and projects, such as the Black Sea Economic Cooperation Zone Agreement, Turkey's associate membership of the European Union and the prospect of transporting the petroleum, natural gas reserves of Azerbaijan and Central Asia through Turkey will also have implications for the TN's maritime strategy.

By achieving stability in the Caucasus region and establishing a network of economic, commercial links (based on mutual benefits between Turkey and its neighbors); the Trabzon and Hopa seaports will become the focal points of transit transportation to the neighboring countries and Central Asian Republics. With this increase in sea transportation through the Turkish Straits and the Danube River, the protection and security of sea lines of communications (SLOC) in the Black Sea will continue to be one of the essential tasks of the TN. Figure 3.1 shows the geographical position of Turkey.

Work on the force structure, training and organization of the TN continues so that they are able to defend Turkey, carry out responsibilities for NATO, and shoulder new



**Figure 3.1 The Geographical Position of Turkey [ Source: Turkishnews Website, <http://www.turkishnews.com.>]**

tasks such as participation in coalition peacekeeping forces under the auspices of United Nations resolutions for preventing war.

### **3. Future Force Structure and Tasks of the Turkish Navy (TN)**

The TN must maintain a high degree of readiness in order to display a presence in the seas bordering the country and to keep the SLOCs open. The TN must be adequate in both quality and quantity to perform all the tasks required by the government.

Recently, the TN has increasingly participated in support operations. In line with the new NATO strategy, the TN continues to perform the following tasks: [Ref. 30:p. 73]

- Defend the integrity of Turkey and the NATO Alliance against all threats,
- Control and protect the SLOCs,
- Assure preparedness to keep bases and ports open which are necessary for the use of the TN and allied navies;

- Defend and keep under control the strategically important straits.

In addition to these military tasks, the following will be important peacetime tasks of the TN in the new era:

- Monitoring of SLOCs with the aim of preventing the trafficking of narcotics, countering international terrorism and controlling refugee movement;
- Participating in the coalition forces formed within the framework of UN resolutions;
- Participating in humanitarian aid operations;
- Increasing port visits with a view to enhancing relations among navies and nations.

## **B. TURKISH NAVY'S SOURCE SELECTION CRITERIA FOR FMS AND DCS**

### **1. General Considerations**

With a view to carrying out those tasks stated above, the TN plans to maintain a force structure capable of meeting emerging risk. To do so, a vigorous program is under way for replacing aged platforms with new ones. Source selection is a very important step in this process. Selecting sources that can best meet the TN's needs is a vital acquisition function. Selections result from a decision making process that must provide for the fair and impartial treatment of FMS and DCS, while minimizing the cost of the process to the TN. The source selection process requires careful planning and execution. When conducting a source selection, evaluation factors support meaningful comparison and discrimination between FMS and DCS.

This research proceeds on the assumption that the TN has already surveyed the international marketplace and has decided to purchase equipment of U.S. origin. The TN must then decide whether to contract to buy the equipment directly from a commercial source or to employ the FMS system for the acquisition.

In general, the choice of either FMS or DCS is driven by the special circumstances, rather than by substantive differences in the two systems. In either case, it is important to note that the identification of materiel requirements, as well as procurement planning and the choice of acquisition method, should be done systematically. However, there can never be a straightforward black-and-white decision, because the criteria are not entirely mutually exclusive. In addition, a number of simultaneous projects may necessitate a different decision from what might appear to be the obvious choice for an individual project. In such a case, however, the established criteria help to reveal more clearly the consequences of the various possible courses of action, while contributing to a more thorough decision. During any decision-making process, it will also be necessary to take into account the capacities of the TN in both qualitative and quantitative terms.

To manage the acquisition of the TN equipment, there are two possible organizations:

- The first is, the Turkish Ministry of Defense(MOD) Undersecretariat for Defense Industries (Savunma Sanayi Mustesarligi) that was created in 1985 as an autonomous agency within the MOD to coordinate Turkey's large-scale procurement programs for each of the individual military services. The Undersecretariat for Defense Industries is a large bureaucratic organization staffed by career civil servants.
- The second is, the Procurement Executive Office within the TN, which coordinates relatively small procurement programs for the TN. These personnel are highly skilled contracting specialists with extensive experience

procuring small sophisticated naval military hardware from both domestic and foreign sources. [Ref. 43]

Unless an item or service is available only via FMS, there are few absolutes, which dictate the selection by the TN of either FMS or commercial methods for any given requirement. Moreover, the selection of one method for a particular acquisition does not require the exclusive use of that same method for subsequent purchases. Rather, there are many considerations involved in each acquisition decision, which are unique to the individual purchaser, and the articles being purchased. From the TN's perspective, the most important of these considerations are summarized below.

## **2. Critical Considerations**

### ***a. Pricing and Financing***

Price is obviously an important issue in the decision-making process. An TN responsibility is the acquisition of items at the best possible price. Therefore the TN wants to know the price of a desired weapon system on the first day it is deployed with the TN. This price must include the total charges for all contractor/subcontractor administration, manufacturing, delivery, training, and support. It is important that all "hidden costs" be identified.

### ***b. Procurement Lead Time***

Timely planning is crucial for the TN in order to obtain the required naval capability when it is needed. Therefore the TN negotiates delivery schedules at the beginning and expects compliance with the schedules during the procurement process. In both FMS and DCS, the delivery time clock starts when an LOA or commercial contract

is signed. Prior extensive planning will allow the TN to prepare for delivery, regardless of which system is used.

*c. Past Performance*

The TN always desires to get the past performance data on the companies involved if it plans to use DCS. Past performance information is one indicator of an offeror's ability to perform the contract successfully. The currency and relevance of the information, source of the information, context of the data, and general trends in contractor's performance are considered.

*d. Contractual Considerations*

The TN desire to participate actively in tailoring the procurement process by fixing delivery schedules, negotiating prices, defining incentives and insuring that designated penalties are stipulated for contractor failure to comply with the contractual agreement. Negotiations between the TN and the U.S. Government or contractor address the TN's specific desires and requirements. One of the significant concerns of the TN is the flexibility in contracting. Such flexibility extends beyond imaginative financial arrangements to include such areas as coproduction in Turkey, counter-trade, or offset.

In order to reduce costs, the TN in most cases obtains quality assurance, inspection, and audit services from USG personnel who are already assigned to defense contractor and subcontractor facilities for both FMS and DCS.

*e. Logistic and Training*

Follow-on support is normally defined as that support provided on a day-to-day basis subsequent to the initial support period and prior to removal of the end item

from the inventory. The amount of support is normally based on a mutually agreed upon rate of operation of the system. It is necessary for the TN to plan early for follow-on support in order to have a mechanism in place once the initial support is finished. Acquisition of a modern, complex weapon system without adequate follow-on support insures that the system will have an operating life far short of its potential. The term "follow-on support" includes spares, repair parts, training, proper tools, test equipment, manuals, special fuels, lubricants, munitions, technical assistance, and modifications. If the equipment being purchased is being used by the U.S. military, the TN may desire to capitalize on U.S. experience and existing USG logistics inventories and training facilities.

Responsiveness is a vital element of support. The amount of time that elapses from the date a customer prepares a requisition until the date the customer acknowledges receipt of that materiel is essential to responsive support. Visibility of assets is one key component to a responsive logistics system. Closely aligned with that is the ability to deliver those supplies quickly when they are needed. During Operation Desert Shield/Storm, thousands of duplicate orders were placed because operational units had inadequate visibility over the status of their requisitions, particularly for critical items. Figure 3.2 summarizes the TN's critical considerations for source selection.

Finally, the objective of the TN is to attain the technical knowledge and training required to independently overhaul and maintain the weapon system, perform system integration, redesign the weapon system, modify software to meet changing operational requirements, and to re-export the technology involved. The bottom-line is, the TN wants to be viewed as a partner, rather than as a customer.

***CRITICAL CONSIDERATIONS FOR THE TURKISH NAVY***

- Pricing and Financing
- Procurement Lead Time
- Past Performance
- Contractual Considerations
- Flexibility in Contracting and Offsets
- Logistics and Training

**Figure 3.2 The TN's Critical Considerations for Source Selection**



#### **IV. COMPARISON OF DIRECT COMMERCIAL SALES AND FOREIGN MILITARY SALES**

##### **A. CONSIDERATIONS**

Once the U.S. Government approves a weapons sale, the TN must decide how to follow through. Whether the TN should purchase U.S. military equipment through the government-to-government FMS program or through the company-to-government DCS avenue is a controversial problem. Both systems have been designed to achieve a common result - the enhancement of mutual security objectives of both nations. They are only different routes, which go to the same destination. The TN's decision on which of the vehicles best meets its needs depends on its estimate of the relative advantages and disadvantages of each. The variables are numerous. The following considerations are designed to help the TN officials to make the best choice for the Turkish Navy. This section provides the practical criteria for making a choice between FMS and DCS in the majority of cases. However, it should not be forgotten that special cases could occur in which other factors play a role.

##### **1. Involvement of U.S. Military Personnel**

Even though the TN has very highly skilled contracting specialists (with extensive experience procuring sophisticated military hardware from foreign sources), the TN still needs the U.S. military advice and assistance in the planning phase of a new procurement. It is important to recognize that whatever level of continuing inter-military contact is maintained, the FMS process creates a government-to-government relationship. The government-to-government obligation has already been shown to be one of the

important advantages of the FMS program. The FMS system inherently engages the TN and the U.S. military in a problem-solution process designed to procure, deploy, and support the item involved. Whether this ongoing contact between the military services of the two countries is necessary, or even desirable, is a binational consideration, which is most often conditioned by the degree of other associations between the two military establishments.

Planning and purchase considerations involved in complex weapon systems, undetermined levels of spare parts, support equipment requirements, operational training, logistics support, selection of suppliers, deployment, doctrine, and tactics require military-to-military contact throughout and beyond the procurement period.

## **2. Contractual Considerations**

The TN must decide whether a DCS or FMS legal agreement is required. In the DCS case, that agreement normally is a fixed-price contract for specified articles and services. Negotiations between the foreign customer and the contractor permit incorporation in the contract of the customer's specific desires and requirements. The fixed price will only vary if provision is made in the contract to permit price changes or the contract is renegotiated to accommodate changes. The firm fixed-price contract holds the highest risks for the contractor but also offers the opportunity for the greatest profits. Under a firm fixed-price contract, the parties agree on a fixed price for the delivery of specified items within a prescribed delivery schedule. The advantage to the buyer is that the contract price will remain constant unless a change is made. In the FMS program, the Letter of Offer and Acceptance (LOA) provides an educated best estimate of the final price for items, which are to be purchased. The DoD is authorized by the AECA of 1976

to play the role of middleman between foreign customers and U.S. manufacturers. If the U.S. Government approves an FMS purchase, it negotiates an FMS price and delivery schedule with the manufacturer. [Ref. 47:p. 3] In short, the U.S. buys the equipment as if it was for U.S. Forces and sells it to the foreign customer. The U.S. transfers the payment from the foreign customer to the manufacturer and collects an administrative fee from the former to cover costs. The tailoring of an FMS process to specific country requirements, (particularly regarding spares and support equipment) often will not occur until after the LOA is signed. Under the standard LOA, the foreign customer agrees to terms and conditions that enable the U.S. Government to change price, delivery dates, source of supply, or even terminate a transaction, without penalty. Moreover, the FMS customer waives its right to sue the U.S. Government for breach of contract. The fact is that the final LOA price is generally lower than the initial LOA price, because the LOA negotiators tend to introduce a safety factor in their initial estimates for unanticipated increases in labor or raw material costs. [Ref. 2:p. 656]

For both FMS and DCS, many contractors and subcontractors may be involved in supplying a weapon system, since no single contractor can normally provide a total major system. Foreign customers, who are knowledgeable of U.S. law and financing, may perceive certain advantages in DCS. The necessary DCS procurement experience, which would permit a foreign customer to play an effective role in such contracts, may be available as a result of previous commercial purchases of other types of items. With this experience, they may wish to participate actively in tailoring the procurement process by fixing delivery schedules, negotiating fixed prices, and insuring that designated penalties are stipulated for contractor failure to comply with the contractual agreement. For

commercial contracts, it is very important for the TN to assess the total resources it must maintain in order to monitor production, evaluate modifications, provide for improvements, assess contract compliance, etc. A large number of highly educated personnel, well trained in international commerce, are required to perform such functions. If the TN assess that it cannot allocate the necessary resources for this process then, the TN should choose to purchase through the FMS system where purchases take advantage of the entire DoD contracting expertise. Under FMS, there is no direct TN involvement in DoD contract negotiations. The TN negotiates directly with DoD in establishing and agreeing to the various requirements specified in the LOA. Once an LOA is signed by the TN, DoD is committed to procuring the FMS items under the same basic contractual provisions which are used for its own procurement. [Ref. 43]

Some common contract administration services, which the TN would likely seek in support of a DCS contract, include quality assurance, inspection, and audit services. These services are provided routinely under FMS, and are components of the overall FMS cost. For DCS, the TN may choose to place its own personnel at the various contractor facilities to perform such services. However, it is more cost effective in most cases to obtain this support from USG personnel who are already assigned to defense contractor and subcontractor facilities.

### **3. Flexibility in Contracting and Offsets**

The TN, which is equipped to undertake DCS contracts, may determine that the more flexible possibilities offered by DCS contracts provide benefits for its weapon system acquisition requirements beyond those available through FMS. While recognizing that offsets have become a reality of doing business in the current arms market, the DoD

nevertheless refuses to be a guarantor of offset arrangements except under very specific circumstances. According to DoD regulations, the responsibility for negotiating and fulfilling offset arrangements rests squarely on the shoulders of the U.S. contractor(s) involved. [Ref. 2:p. 664]

Although offset provisions cannot be included as a part of FMS negotiated contracts, they can be addressed under separate contractual arrangements mutually agreed to by the TN and the U.S. contractor. The net effect of this approach for the TN, however, is a two-step process which will likely take longer to negotiate and could result in disconnects between the FMS contract and the offset arrangement.

DCS, on the other hand, enables the TN to exercise a greater degree of flexibility in contracting with U.S. industry than is possible through FMS. This is true because U.S. industry has no structured, regulatory guidance, such as the FAR, which must be followed in FMS contracts with the TN. Such flexibility extends beyond imaginative financial arrangements to include such areas as industrial participation, and countertrade. The degree of success that the TN may achieve in attaining its contract objectives is subject only to the skill of its negotiators, the level of its need for a particular item, the contractor's resources, and the level of the contractor's need for the purchaser's business.

#### **4. Bureaucracy**

##### ***a. Public versus Private organizations***

The FMS program does not operate, like the commercial sector, although many features of the commercial sector are present (e.g., contracts, price and availability data, delivery schedules). The inherent difference is that the organizations that implement

FMS programs are not commercial sector oriented; they are public sector (budget-based from taxes) bureaucracies. Their behavior is significantly different, resulting in responses that are not typical of the commercial sector. The FMS bureaucracy has to be responsive to the President and the Congress as mandated in the Arms Export Control Act of 1976.

The FMS bureaucracy will support the foreign policy interests of the United States regardless of its constraints. As stated in Chapter Two, the sense of the Congress will prevail in the FMS program. The FMS program is preserved as a vital tool of the U.S. foreign policy. Foreign policy is very volatile, fluid and political. In essence it is flexible enough to exploit opportunities as they occur. FMS as a tool is purposely designed to remain nebulous in order to be available for the shapers of foreign policy.

***b. The Procurement of three Perry Class Frigate Case***

This case was taken from the Master's Thesis of Eser Cimenderoglu with the title "Analysis of Transferring U.S. Navy (USN) Perry Class Frigates to Turkey and Issues Raised During the Process" in 1997.

The TN embarked upon an intensive program to modernize its ships to bring them in line with emerging technologies as stated in Chapter Three. To modernize, the TN decided to acquire three Perry class frigates from the U.S. The transfer of U.S. Navy ships to the TN mainly occurs through FMS. The offer of transferring three Perry class frigates to the TN was initiated on November 1994 with a letter from the USN Chief of Naval Operations (CNO) to the Commander in Chief (CINC) of the TN. Progress during the transfer process of the frigates to Turkey was successful up to the actual transfer of the ships. [Ref. 46:p. 40] The regulations were strictly followed and the officials of the two governments agreed to every decision. The Congressional notification

of this transfer was provided to the Congress on March 29, 1996 by the DSAA. The transfer of the ships was approved following the required waiting period of 30 days without any objection from the Congress. The estimated transfer date was 15 May 1996. As the transfer of the frigates was nearing completion, an unexpected event occurred on December 25, 1995. A Turkish cargo boat ran aground near an Aegean islet Kardak (or Imia). The process of freeing the cargo boat and towing the ship then became an argument between Turkey and Greece. This incident created a dispute over the sovereignty of the Kardak islet.

On April 17, 1996, Senator Arlen Specter (R-PA) proposed a resolution, which was referred to the Committee on Foreign Relations, expressing the sense of the Senate regarding the dispute between the two countries over sovereignty of the Kardak islet in the Aegean Sea. In the second version of this resolution, dated April 19, 1996, Senator Mikulski (D-NY) joined Mr. Specter as cosponsor.

This resolution expressed the sense of the Senate that the governments of Greece and Turkey should:

- Submit to the International Court of Justice in the Hague their dispute over the Kardak islet in the Aegean Sea; and
- Agree to be bound by the Court's decision with respect to the dispute.

Two more cosponsors were added to the bill on April 22 and June 13 respectively. These senators were Mr. Moynihan (D-NY) and Mr. Santorum (R-PA). However, Turkey and Greece didn't express the same interest. On the contrary, the opinion of these countries was that the decision to go to an International Court was a domestic issue for each country and shouldn't be influenced by a third party. [Ref. 46:p. 45]

Although the two events mentioned above were not directly related to the transfer process, the highest executive and legislative branch authorities held up the transfer. It was felt that delivery of three war ships to Turkey might affect the senators' image to the public, causing a negative impact during the approaching election campaigns.

Even though the dispute between the two countries over sovereignty to the Kardak islet in the Aegean Sea is still unsolved, the TN received these three frigates at the beginning of 1997 after elections. [Ref. 42]

## **5. U.S. Constraints on FMS and DCS**

Even though DoD is generally neutral to FMS or DCS, U.S. manufacturers that are the sole producer of an item for DoD can request that such items be sold to foreign customers only by DCS. Such requests are identified in the DSAA's "Contractor Preference For DCS" listing. Where the U.S. manufacturer has been approved for contractor preference, DSAA policy requires that prospective purchasers be informed of the contractor's preference for commercial sales. If after such notification the customer still wishes to purchase through FMS, it must provide justification to DoD for an FMS procurement. [Ref. 2:p. 663]

On the other hand, some equipment on the Military Articles and Services List (MASL) is not releasable to particular countries on DCS basis; therefore some sales may be directed into the FMS process because of the reasons stated below: [Ref. 47:p. 11]

**a.     *Sophistication of Technology***

Items generally are classified as FMS-only cases if they are deemed technologically sensitive or if they involve special logistics or training requirements. The sophistication of technology may prevent a sale of equipment to either one or more countries. One example is the shoulder-launched Stinger air defense missile, which can easily be diverted to terrorist use. Another example is when the U.S. has a "for U.S. only" and an "export" version of the same weapon system. Only a few close U.S. allies have been permitted to buy the U.S. version.

**b.     *Classification***

Military Articles and Services List (MASL) items become classified if they contain a classified component. Even if the equipment is not classified, the technical or performance data may be classified. Each country is cleared to receive equipment or information up to a certain level of classification. Thus, if an item is "secret" but a country is only cleared for "confidential" the equipment is not releasable to that country unless an exception is approved. Classified components are usually sold under FMS. However, commercial sales to approved countries may be possible as long as the classified information or item is transferred from an U.S. Government official to a foreign customer's official.

**c.     *Government-Furnished Equipment (GFE)***

When the U.S. buys a piece of military equipment, it may supply some of the components to the manufacturer. These components are referred to as Government-

Furnished Equipment (GFE) and are a result of either an U.S. Government purchase or production.

GFE can only be purchased through the FMS channel, but procedurally, the manufacturer can act as the agent for the foreign customer and sign all necessary FMS forms. However, since most GFE is simply equipment purchased commercially by the U.S. Government (equipment manufactured to government specifications), satisfactory commercial substitutes are often readily available and, in fact, both may come from the same production line. Although many of these items are also available commercially, the bulk-buys by the government create lower prices than are perhaps available on smaller commercial purchases. As a result, it becomes attractive to acquire the items GFE. Also, sometimes the U.S. Government may have a production line tied up so the item can only be acquired GFE.

Some GFEs have no commercial sources because they are manufactured or assembled in a U.S. Government arsenal. Some GFEs are highly classified and are only sold on an FMS basis. Certain radar and cryptographic equipment fall into this category.

## **6. Procurement Lead Time**

Unlike the diversity of opinion about other considerations, most people agree that delivery can be received earlier under DCS. Since production takes the same length of time, delays occur between the point of request and the signing of the contract. Most U.S. and the TN officials agree that FMS takes longer because of the levels of review required in the government and the need to negotiate with two entities; the foreign customer and

the U.S. manufacturer. Time becomes important because of immediacy of need, price, and continued availability of funds. According to Col. Werner Kunerth who is defense cooperation attaché at the at the Austrian Embassy in Washington D.C., the constant frustrations, delays and expense of the FMS process are driving more and more countries to either purchase non-U.S. products or U.S. products from private industry. [Ref. 12:p. 32]

On the other hand, the TN should understand that once the delivery period in a commercial contract has been established, it seldom is changed. In cases of emergency for the TN, and assuming the materiel is available in DoD inventories, it may be possible for the TN to achieve faster delivery through shipment from DoD stocks or through the diversion of items that are under production for DoD procurement. This is true because DoD can subsequently replenish its inventory with the items that are being procured for the foreign customer. The possibility of diversions or withdrawals from DoD stocks in bona fide emergencies should be weighed carefully by the TN before a choice is made between DCS and FMS program.

## **7. Pricing**

The price of a particular defense item can vary significantly depending on the quantity of production, the learning curve, time of delivery, and configuration. These factors make it difficult to compare actual transaction to determine whether FMS or DCS's prices are lower. Additionally, both industry and the U.S. Government tend to discourage cost comparisons. Nevertheless, frequently countries do shop for the best price, asking the U.S. for an FMS price and at the same time asking the manufacturer for a commercial price. The U.S. companies point out that a DCS's price is lower than a

corresponding FMS price because it avoids the U.S. Government's administrative charge and it is less likely to be affected by inflation (due to the shorter commercial procurement cycle). Government officials, on the other hand, argue that if commercial prices are lower it is because they do not include adequate support or training. Additionally, they state that companies make a larger profit on DCS than on FMS. Profits are limited to a fixed percentage on FMS and are negotiated under Government regulations. Although U.S. companies readily admit the higher commercial profit margins, they point out that since the FMS service charge is based on a fixed percentage; the U.S. actually makes a profit on a higher-dollar value FMS sale. Companies believe that higher margins are justified by the greater risk of doing business overseas and feel they are controlled by the market and competition, including the FMS process itself.

Because of the uncertainty about the future and risk to the security of Turkey still remain, the urgency of need may affect the price of the defense item. Under this circumstance DCS is more responsive than the FMS. But the TN may pay more, because the urgency of need reduces competition and decreases the TN's leverage in price negotiations. Contractors normally do not produce items in anticipation of sales and generally do not maintain an extensive inventory of defense articles.

DCS systems, which are produced by two or more manufacturers often, can be made for less than the FMS price. Items sold under intensely competitive circumstances may occasionally be obtained at fixed prices which are below cost/profit margins allowable under DoD contracting regulations, especially when both U.S. and non-U.S. suppliers are in competition for the sale. Price advantages under DCS may be possible

during times of rapid inflation in the United States, especially if the contractor has the ability to make quick deliveries from off-the-shelf inventories or rapid new production.

The issue of "hidden costs" in both commercial contracts and FMS agreements requires clarification. The FMS administrative surcharge and contract administration costs that are added to the basic price of an FMS agreement are obviously functional costs of the FMS procurement process. Except for specific statutory exemptions, all USG expenses for FMS program implementation must be recovered from the TN. The administrative surcharge consists of costs involving sales negotiations, case implementation, contract negotiation, contract management, financial management, reports of discrepancy, etc. Contractor profits are also included within the final FMS price, but are limited by the provisions of the FAR. Conversely, the marketplace establishes the profit ceiling for commercial contracts. The TN will not normally have access to information which reveals how much general and administrative expenses (G&A) cost or overall contractor profits are included in either a DCS or FMS. Most foreign customers complain about pricing in FMS. The following case, taken from the Inspector General Report that was published in 1994 with the title of "Procurement Prices Paid on Missile Systems for FMS", demonstrates the problems found in FMS programs.

[Ref. 45:p. 1]

*a. Case Introduction*

In FMS, customers procure missile systems from the Program Offices through Letters of Offer and Acceptance. The Program Office contracting officers negotiate missile system procurements with contractors for DoD and FMS customers. With the exception that prices for FMS can include contractor and U.S. Government

additive charges not applicable to DoD prices, the Program Offices are required to provide FMS customers the same contract pricing afforded to DoD.

***b. Objectives***

The objectives of the audit were to determine whether FMS prices paid to DoD contractors for missiles were comparable to prices DoD paid. The inspectors also determined whether contractor and USG additive charges were valid and accurate.

***c. Audit Results***

FMS prices were higher than DoD prices for comparable procurements of these missile systems. Also, contractor and USG additive charges, in some cases, were not valid or accurate.

- The U.S. Army did not negotiate Patriot missile contract prices for FMS customers that were comparable to prices negotiated for DoD. In addition, the U.S. Air Force did not report the appropriate contract prices for billing FMS customers for purchases of Sidewinder and Maverick missile systems. The FMS customers paid \$1.3 million more than DoD, while the Netherlands paid \$1.7 million more than Germany did for comparable purchases of Patriot missiles. Also, the Air Force overbilled FMS customers \$3.4 million for Sidewinder and underbilled FMS customers \$3.5 million for Maverick.
- The Program Offices did not accurately bill FMS customers for contractor and U.S. Government additive charges included in contract prices. As a result, the program offices overbilled some FMS customers \$13.5 million and underbilled some other FMS customers \$2.0 million as a total.
- The U.S. Navy on Harpoon and the U.S. Air Force on Sidewinder recouped more than reasonable (Special Defense Acquisition Fund investment) costs for modifying these missile systems for FMS

customers. The Air Force billed customers prices in excess of actual costs for Maverick missiles sold from the Special Defense Acquisition Fund inventory. The Navy inappropriately billed 18 FMS customers \$2.5 million for the Harpoon missile system, the Air Force overbilled FMS customers \$9.9 million for the Sidewinder missile system and \$1.9 million for the Maverick missile system.

#### **8. Financing and Trust Fund**

Another major consideration in the choice of acquisition method is total financing requirements. In addition to other variables, financing requirements may be dependent on the precise capabilities the TN wishes to acquire.

The U.S. Government requires an initial advance deposit and quarterly payments that are held in an FMS trust fund administered by the Defense Finance and Accounting Service and managed by DSAA. One special feature of the FMS system involves the use of cross-leveling agreements. Such agreements allow country funds, which are on deposit in the FMS trust fund to be moved to and from special holding accounts, or moved between separate FMS program, thereby maximizing the use of country funds. This practice is in contrast to DCS contracts, which stand-alone and typically provide for fixed prices, with fixed payment schedules, but with no provision for the movement of funds between individual contracts. [Ref. 13:p. 34]

#### **9. Logistics and Training**

An important consideration in the purchase of any major weapon system is the extent of logistics and training services required during both the acquisition and follow-on support phases. If the end item being purchased is in use by the U.S. military, an FMS procurement might prove most desirable since the TN could thereby capitalize on U.S. experience and existing USG logistics inventories. Under a Cooperative Logistics

Supply Support Arrangement (CLSSA), the entire DoD inventory and contracting system can be drawn upon to support the TN requirements: This can be accomplished simply by the submission of requisitions for individual parts. In effect, the DoD logistics system serves as a procurement staff for the TN by procuring its required items from the U.S. There are some U.S. contractors who are also capable of providing full logistics support for the items which they sell. Since the company reputations depend on good performance, these contractors have the capability of furnishing satisfactory support.

The TN is currently using both FMS and DCS for new weapon systems. Decisions on logistics are being made on a case by case basis. The TN has also a number of former U.S. Navy ship systems which have a lot of spare parts and support equipment that are not available in the inventory of either the U.S. Navy or U.S. manufacturer. The U.S. Navy announced on August 17, 1995 the award of a contract to provide services to governments operating former U.S. Navy ship systems through the FMS program. This supportability contract provides the advantage of one-stop shopping for technical support and materials for the maintenance of ship systems bought, leased or transferred to other countries through the FMS program. This approach exploits economies of scale by identifying a single contractor to support similar classes of ships worldwide. At the same time, the contractor has the advantage of access to foreign markets, establishing relationships with foreign customers, and income from overseas markets. This method is currently being used by the TN for the Knox and Perry class frigates. {Ref. 42]

This innovative way of doing business will also enable the TN to receive high-quality support services from U.S. industry for systems and equipment, which are no longer in service in the U.S. Navy.

One of the challenges that the TN faces is to determine the stock level for adequate follow-on support. Recommendations of stock levels come from the U.S. Government and U.S. industry, and these levels are based on either US domestic usage figures, or from other similar FMS program consumption figures. The TN can accept the recommendation, or tailor it to its own expectations of consumption. (Often, the TN's budget doesn't allow the purchase of everything that is recommended.) Usually the TN makes its best estimate, and then, over time, the stock list is renegotiated to more accurately reflect actual usage. Several U.S. Government officials said that industry often does not recommend enough spares in order to entice foreign customers with a lower price. Companies, on the other hand, claim the military recommends too high a level. Industry argues that a lower level of spares is feasible because they supply parts quicker, if necessary, than the military. [Ref. 44]

Follow-on support is linked directly to weapon system operations and maintenance crew training. It is important to identify the extent to which the TN will need training, and to determine whether the training will be provided by either the contractor or the USG, or through a combination of both.

## **B. TRENDS IN FOREIGN MILITARY SALES (FMS)**

### **1. FMS and Defense Security Assistance Agency (DSAA)**

The FMS program lacks clear, concise objectives with measurable parameters to determine its effectiveness and efficiency. Such a broad-brush conclusion could be leveled at any bureaucratic structure. If, for example, objectives were clear and effectiveness could be measured, the general view of FMS would be more in tune with a

commercial approach to the problems. The political realities of FMS will not allow such a situation to become a reality, because each country wants to be treated a bit differently from the next. Each desires to have products built to their specifications. Because the foreign customers are paying the fare, they expect special treatment, which can not always be accommodated by a standard system. Thus, FMS programs become tailored and expensive.

DSAA is the agency that performs administrative management, program planning, and contract functions for the U.S. military assistance programs (including FMS) under the policy direction of the Assistant Secretary of Defense (International Security Affairs). Therefore the performance of DSAA is very relevant with the efficiency of an FMS program. There is also no method of measuring the effectiveness or efficiency of the DSAA. It continues to perform its mission. Cases are negotiated, implemented, and completed while products and services are transferred.

## **2. Recent Improvements in FMS**

Four major areas of Reform Initiatives by the Secretary of Defense William S. Cohen are: [Ref. 48:p. 3]

- Reengineering: Adopt modern business practices to achieve world-class standards of performance.
- Consolidate: Streamline organizations to remove redundancy and maximize synergy.
- Compete: Apply market mechanism to improve quality, reduce costs, and respond to customer needs.
- Eliminate: Reduce excess support structures to free resources and focus on core competencies.

These initiatives added to other requirements are causing substantial changes to DSAA and to FMS. At this time it is difficult to associate specific changes to his initiatives versus broader changes that are being examined, developed, or implemented.

There are examples of changes coming from these Reform Initiatives.

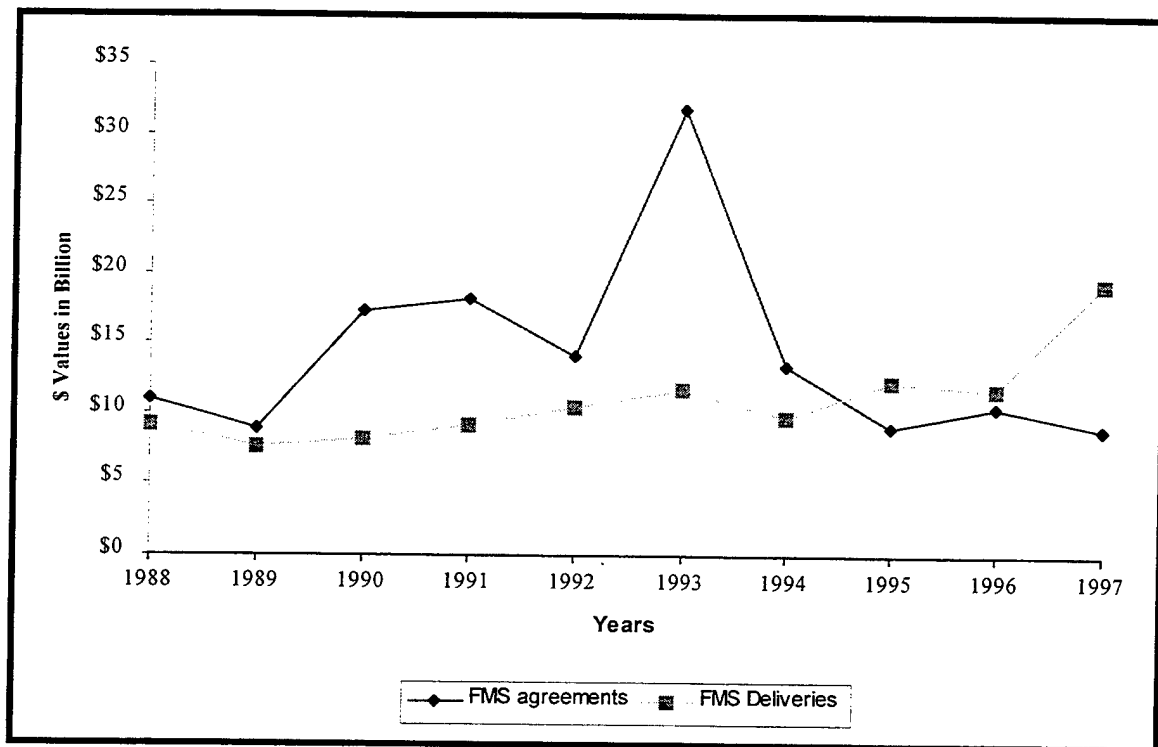
- One example is the reorganization of DSAA, some of which has already occurred and the balance is to be completed effective 1 October 1998 when the Defense Security Assistance Agency (DSAA) will become the Defense Security Cooperation Agency (DSCA).
- A second example is the accelerated transition to digital, versus hard copy, information. Examples of this are the availability of publications (such as the Security Assistance Management Manual, or SAMM) electronically and the consolidation of several fragmented automated systems into a central management system, referred to as the Defense Security Assistance Management System (DSAMS).
- A third example is that U.S. Air Force, with encouragement from DSAA, is instituting a variety of reforms to become more responsive to its customers without jeopardizing what they call "the blue suit-to blue suit value" of an Air Force FMS program. Proposed reforms include itemization of charges, expedited case closures and the possible hiring of private contractors to manage selected Air Force Programs [Ref.12: p.34].

There are numerous changes under consideration and the final results of many are yet to be determined. These changes are designed to maintain current levels of customer support and to improve on the support in many areas while adjusting to lower resource levels. [Ref. 38]

### **3. Analysis of FMS in the Last Decade**

#### ***a. Variances in Annual Sales Levels***

Figure 4.1 reflects the general trend in overall FMS as the sales levels jump around. On the other hand FMS deliveries are more stable from year to year and

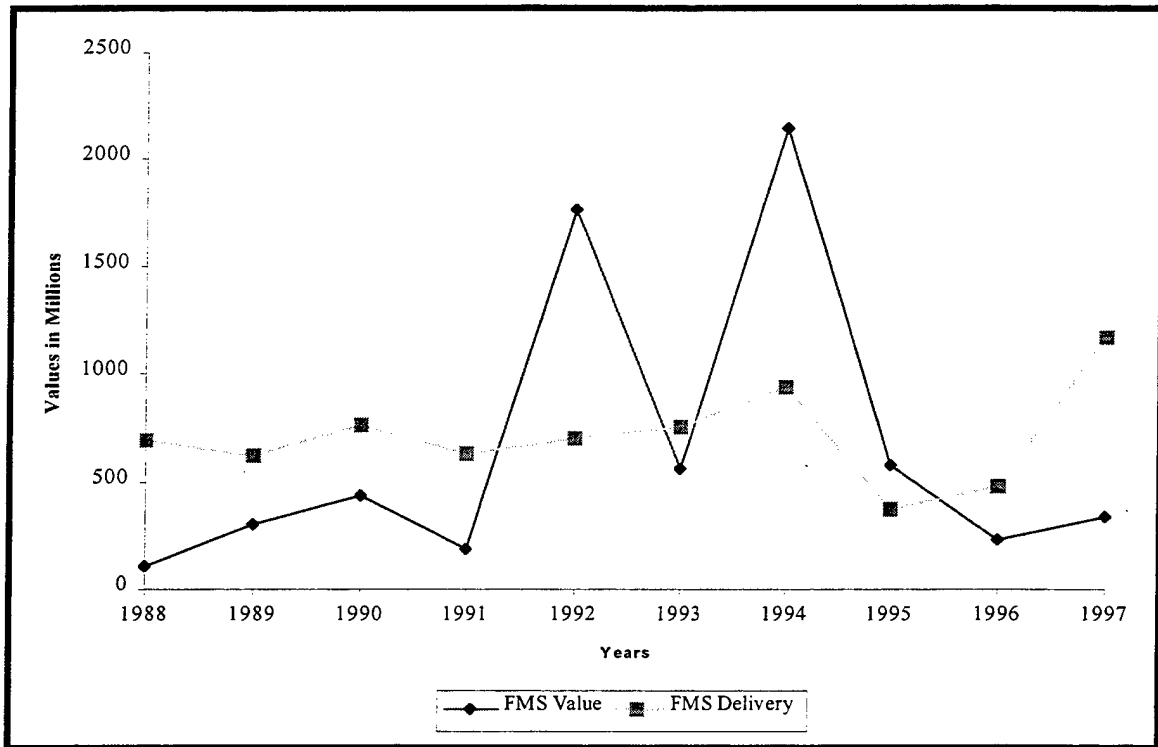


**Figure 4.1 Total FMS Agreements & Deliveries [Ref. 31:p. 1,17]**

represent a more accurate measure of FMS performance. The zigzag effect in annual FMS agreement levels is likely due to several factors, to include:

- world events (e.g. the Gulf War),
- other nations' budget priorities and realities (upsizing, downsizing),
- the U.S. Government review and approval process (election years),
- the variance in the levels of annual major system sales (expensive vs. less expensive systems),
- the understandable, yet somewhat artificial, practice of tallying sales by the U.S. fiscal year (legislators and budget analysts like fiscal years).

The FMS purchases by Turkey follow the same kind of zigzag pattern. While FMS deliveries are more consistent from year to year. Figure 4.2 shows the FMS agreements and deliveries for Turkey. [Ref.31:pp. 4,20]



**Figure 4.2 FMS Agreements & Deliveries for Turkey [Ref. 31:pp. 4,20]**

### **C. TRENDS IN DIRECT COMMERCIAL SALES (DCS)**

DCS, or commercial exports of items on the United States Munitions List, are another means for countries to acquire American defense equipment. The long-standing policy regarding such sales is that the U.S. government is generally neutral as to whether a country chooses to fill its valid defense needs through FMS or DCS methods. Review of the DCS Granted License and Deliveries data in Figure 4.3 and 4.4 over the past ten years reveals that DCS programs are suffering a downturn similar to that of FMS because of the overall sluggishness in the world wide defense market. [Ref. 33:p. 13]

#### **1. Data Consistency and Predictability**

It is hard to compare FMS and DCS, because there is big gap between the DCS Granted Licenses and Deliveries. It is not an "apples to apples" comparison, because one

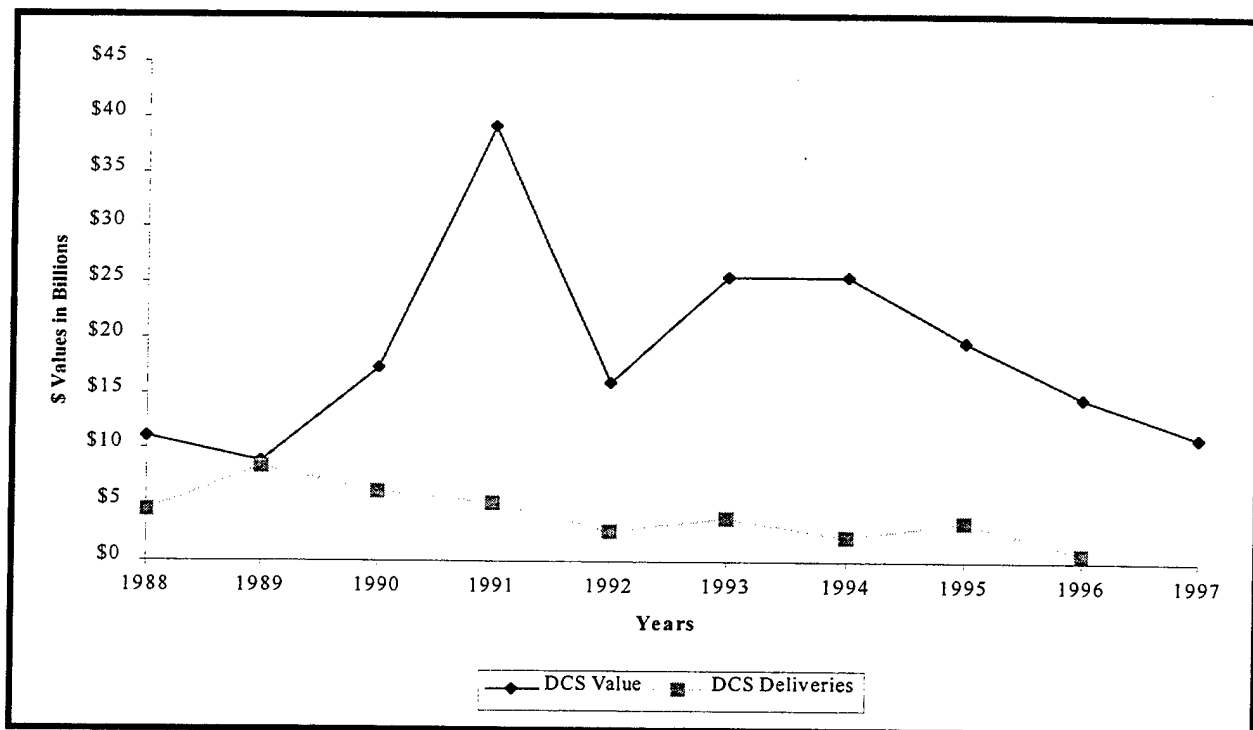


Figure 4.3 DCS Granted Licenses and Deliveries [Ref. 32, 33:p. 13]

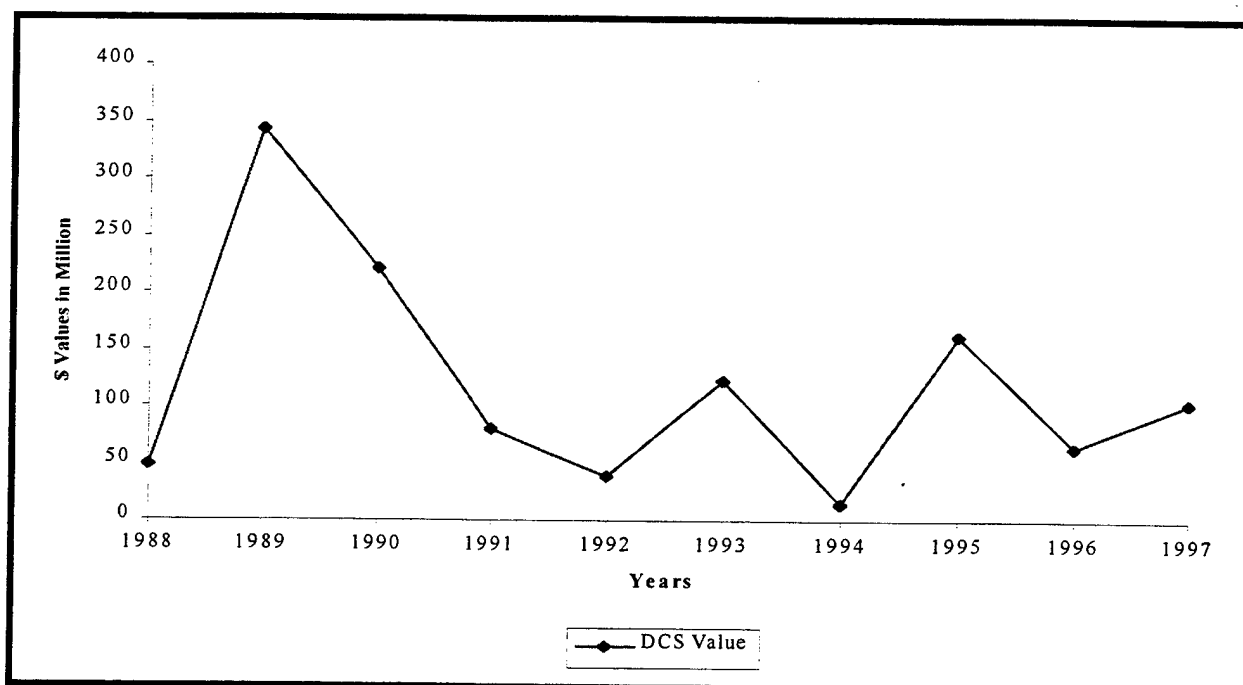


Figure 4.4 DCS Granted Licenses for Turkey [Ref. 31: p. 62]

can really only track the value of export licenses that were granted and not actual deliveries. During the 1984-1989 period, matters changed dramatically: commercial exports experienced a relatively steep climb, from about 60 percent of total FMS deliveries. Additionally, while DCS levels went up, FMS deliveries declined slightly from the previously high peak in 1983. In 1989, DCS deliveries in the amount of \$8.4 billion exceeded FMS deliveries of \$7.5 billion for the first and only time. Between 1990 and 1996, commercial exports started to decline while FMS deliveries began to swing up again, with commercial exports averaging out at about 40 percent of FMS deliveries. [Ref. 31:pp. 1,17]

As to why DCS deliveries declined immediately following the Desert Storm period, while FMS levels went up, the reasons are not clear. This phenomenon might be partially explained by budget limitations (i.e., purchaser countries just can't afford to have FMS and DCS at the same time). It is likely that the following factors are involved: budget levels, threat perceptions, modernization plans, and so forth. Data aberrations are further masked by delivery lead-times on the part of the United States, with equipment deliveries normally occurring after advance cash payments have been received from the foreign customer. Figure 4.4 reflects values of the DCS granted licenses for Turkey. Deliveries of Air-borne Warning and Control System aircraft to Japan; C-130J transport planes to Australia and Britain; and AH-64D Apache helicopters to the Netherlands and Britain are expected to begin later in 1998. All of these purchases were conducted primarily through DCS. [Ref. 12:p. 34]

## **2. Why U.S. Firms Seek International Business**

With defense budgets declining and few major development programs on the horizon, many U.S. defense firms are seeking additional foreign business. While the U.S. controlled about 62 percent of the total non-communist world aerospace market in 1988, its share may drop to 53 percent by 2000 and to just half by 2010. [Ref. 37:p. 55] For U.S. defense firms to survive, let alone prosper, without reorganization or industry-wide restructuring, they will have to make foreign sales a larger part of their business.

Many of the larger U.S. firms will start from a small foreign business base. Others, like Lockheed Martin and McDonnell Douglas, are heavily involved in international markets. When such firms compete overseas, they are at a disadvantage when compared to national firms with substantial local operations.

Most of what U.S. firms sell overseas is originally designed for the U.S. military and then modified for export purposes. U.S. weapons sold overseas are often somewhat less advanced and have less capable "black boxes" than those sold to the U.S. military. An executive whose company has been quite successful in exporting defense equipment explained that his company "is not in the business of designing systems for foreign customers. It designs systems for U.S. customers that can be sold overseas. What you have in stock at any point in time is what you offer to foreign customers. [Ref. 37:p. 56]

Despite these obstacles, many U.S. defense manufacturers need more foreign business to ensure profitability and survival. Foreign business lowers unit costs of production, increases returns on research and development, offsets declining business.

### **3. What the U.S. Defense Industries Want**

First, industry complaints about FMS are only part of a broader critique of the export control regime that appears to have outlasted the Cold War that established it. The defense industry's position is that the government has a legitimate interest in protecting the defense industrial base by promoting arms exports.

Second, industry representatives want DoD approval for in-country demonstrations of U.S. weaponry. Many countries will not buy weaponry without such demonstrations. [Ref. 37:p. 66]

Finally, the industry would prefer more DCS instead of FMS. Government-to-government memoranda of understanding (MOU) makes sense where sensitive military technologies are involved. But some industry sources claim that MOUs are often negotiated where coproduction or codevelopment is not involved. By permitting more direct sales, the U.S. Government would give domestic firms a more competitive advantage. [Ref. 45]

### **D. WORLD ARMS SALES**

Looking back over history, the United States began as the preeminent exporter of military equipment, accounting for about 35 to 40 percent of the world export total in the mid-1970s. During the 1965-74 period, the U.S. share was even higher in earlier years; data from the Arms Control and Disarmament Agency (ACDP) demonstrate that the U.S. accounted for 49 percent, compared to the Soviet Union's 29 percent. [Ref. 34:p. 73] The Soviet Union nudged the U.S. out of first place in 1978 with the Soviet share being just over 33 percent while the U.S. share was under 28 percent. [Ref. 35:p. 20] During the period 1979 to 1989, the Soviet Union retained the top position every year but one 1983

when the United States led by a two percent margin with over 28 percent of the world export total. The two countries tied for first place in 1990, each sharing 33 percent of the market. From 1991 to 1994, the United States was the dominant supplier by a relatively large margin over the other supplier nations. [Ref. 36:pp. 1,15] A Congressional Research Service study, which examined arms transfers to developing nations, showed that during the 1988-95 period, the U.S. ranked first in arms transfer agreements with developing nations with about 36 percent of the total. In 1995, Russia accounted for almost 39 percent compared to the U.S. share of close to 25 percent of total agreements with developing nations. [Ref. 33:p. 12]

## **V. CONCLUSIONS AND RECOMMENDATIONS**

### **A. CONCLUSION AND RECOMMENDATION**

Both FMS and DCS help to increase standardization and interoperability between the U.S. and its Allies. Cooperation is important to the U.S. security for three reasons. First, the U.S. forces are being reduced, lessening U.S. forward presence and causing the U.S. to be more reliant on NATO and the U.S. allies to assist in future conflicts. Second, by selling weapons to the U.S. allies, the U.S. can influence the allies to "play by the US rules". Finally, cooperation provides NATO and the U.S. with the assurance that allies can fulfill their mission when required. To fulfill their mission, they must be equipped with state-of-the-art, high technological equipment.

The choice of either FMS or DCS is driven by the special circumstances of the foreign customer, rather than by substantive differences in the two systems. The final decision on procurement method tends to vary from country to country, and even from purchase to purchase. This thesis has shown many considerations involved in the selection between the FMS and DCS method. These acquisition decisions are unique to the individual customer, as well as to the articles being purchased.

The TN should base its procurement selection on considerations of needs, priorities, and purchase. It is essential for the TN to obtain the required military capability when it is needed. With a limited budget, the most important considerations for the TN are;

- capability to negotiate a direct contract which will assure timely delivery at a fair price,

- logistics and training support needs,
- degree of need and desire for the involvement of U.S. military personnel,
- price and procurement lead time of item or service purchased,
- flexibility in contracting.

The purpose of this research was to analyze the FMS and DCS methodologies and to identify their advantages and weaknesses. Interpretation of the information, which was gathered from the literature and observations by the author, led to the following conclusions and recommendations:

1. Conclusion: In order to take full advantage of the FMS and DCS, the TN must become and remain acquainted with the U.S. procurement organizations, procedures and methods.

Recommendation: It is necessary that the TN has a thorough knowledge of the procurement organizations and procedures of U.S. acquisition systems, the program management methods being followed, the control of those methods, and the legislation and regulations governing procurement in the U.S. Moreover, this knowledge will have to be updated constantly. The TN should also utilize the Naval Postgraduate School, Systems Acquisition and Acquisition and Contract Management curricula to assist its managers in overcoming the language barriers.

2. Conclusion: It has to be realized that it is not possible to make a generalized direct comparison between procurement through FMS and DCS of defense material and/or services. One can, however draft criteria helping, the TN make a choice between procurement through FMS and DCS.

Recommendation: FMS is preferable if the required product is or will be in use with the U.S. armed forces and one or more of the following factors apply:

- Cooperation with the Service in the US is desired even after actual procurement.
- The requirements of the TN can be combined with those of the US and/or third parties to form a single project, thereby producing economies of scale.
- The product is advanced and complicated (e.g. weapon systems or large components of such systems) and/or involves systems which have a substantial software components for specific military applications.
- The end product contains sub-systems, which are supplied as "government-furnished equipment" by the US government to the supplier of the end product. In the case of DCS, such sub-systems are in principle obtained by the supplier in question from other suppliers. Depending on the proportion of sub-systems in an end product, this can increase the costs very considerably because of the loading (overhead and profit) which the supplier of the end product charges. Such loadings are avoided by procurement through FMS.
- Spare parts, consumer goods and/or repairs, can be obtained through a Cooperative Logistics Supply Support Arrangement (CLSSA).
- If the product is classified

DCS is preferable in the following cases:

- Either the product is not a standard product with the US armed forces or it differs to a significant extent from such a product.
- The product is needed urgently and cannot be obtained, or cannot be obtained in sufficient numbers through CLSSA (this applies mainly in the case of spare parts and repairs).
- The product does not have a specifically military character (e.g. communications equipment, automation systems and some radar systems).

There is no preference for either FMS or DCS in the following cases:

- The product is well defined and can be used as an independent unit.
- The requirements of the TN cannot be easily combined with those of the U.S. and/or third parties, for example because of differing procurement schedules.

- The product is of US origin, but orders for purchase or repair can be placed elsewhere too, for example with a coproducer in Europe.

Upon closer inspection of sales examples, I saw that some of sales combined both DCS and FMS. Although total commercial and FMS contracts do exist, the frequent combining of the two contracting methods, in significant sales, reflects the fact that the advantages of the two contracting methods are not absolute and tend to be offsetting. (U.S. government and industry sources, as well as the TN officials, suggest that hybrid commercial-FMS packages, such as the Japanese Airborne Warning and Control System package or the Israeli F-15 fighter sale, are the wave of the future.) [Ref. 12:p. 34] A combination FMS-DCS program that is often described as an FMS-Plus or FMS-Plus-Plus package, allows the foreign customer to maintain the military-to-military connection, and opportunities for training, upgrades and support, while squeezing the best value for money from components of the package procured through the private sector. For example,

- Buy commercial for faster delivery but purchase FMS for cost audit, equipment inspection, and logistics and support services; or
- Purchase some components of a system through FMS for lower cost and risk, but purchase spare parts commercially.

3. Conclusion: As the foreign customers become more technologically savvy and self-confident in the current buyers market, several U.S. top customers are beginning to drop the FMS route in favor of more customer-friendly DCS. The reasons for using DCS are: faster delivery, new equipment, flexibility in contracting, fixed price with penalty for late delivery, avoidance of FMS administrative fee, negotiating directly with

the manufacturer rather than through a middleman, less bureaucratic red tape, and the support is tailored to foreign customer needs.

Recommendations: The U.S. must improve and streamline the FMS system to become more businesslike. The FMS procedures need to be brought up to date, so that some of the better commercial practices in DCS can be applied to FMS.

The U.S. officials should also recognize the need to adapt to changing market conditions, and growing expectations within the international community for greater cooperation and partnership opportunities.

More information should be provided to foreign customers both before and after the signing of the LOA in FMS programs. A foreign customer should be able to attend negotiations and price investigations.

4. Conclusion: Foreign customers use FMS, because it promotes standardization, interoperability, military specification compliance, Government-to-Government obligation, access to military training, and economies of scale because of U.S. government bulk procurements.

## **B. AREAS FOR FURTHER RESEARCH**

- Comparison of U.S. and non-U.S. sources for the acquisition of the weapon systems.
- How could the Reform Initiatives by the Secretary of Defense William S. Cohen be applied to FMS process?
- How could one measure the performance of the FMS process?



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